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Morality and Securities Fraud

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MORALITY AND SECURITIES FRAUD

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Securities fraud features prominently in conversations about financial reform, and for good reason. In addition to the disproportionate number of securities fraud lawsuits and government actions filed every year, securities fraud case law is frequently consulted as an analytical aid for other types of corporate fraud. And yet, in discussing the interpretation and application of the securities laws, scholars, judges, and lawmakers alike have largely overlooked a feature of securities fraud that could offer significant assistance in many challenging areas: namely, that securities fraud, including civil securities fraud, has a pronounced moral dimension.

This Article explores the role that moral judgment plays in the development and application of the law of civil securities fraud. It argues that civil securities fraud is a morally charged concept, and liability for securities fraud is a pronouncement of moral blameworthiness. Recognizing this moral dimension offers both descriptive clarity about the development and application of securities fraud liability, and prescriptive guidance for judges, litigants, and lawmakers navigating the often fraught landscape that is securities fraud law today. On a broader stage, the morality of civil securities fraud offers new ideas for principled legal reform and explorations of new methods of fraud prevention.

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I. INTRODUCTION

Morality and big business are not concepts that have intertwined comfortably in recent years. As scandal after scandal plague the financial and commercial industries, many have lost faith that governments can effectively regulate and police corporate activity. New rules and regulations are promulgated, lawsuits are filed, and civil and criminal penalties rise, but commentators ponder whether demonstrations of compliance and fair dealing are no longer valued in corporate culture.[1] Increasingly, companies appear to flock toward methods of demonstrating their values and integrity that are more

1. *See, e.g.*, Julian J. Z. Polaris, Note, *Backstop Ambiguity: A Proposal for Balancing Specificity and Ambiguity in Financial Regulation*, 33 YALE L. & POL'Y REV. 231, 235–37 (2014); *see also* JONATHAN R. MACEY, THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET (2013) (arguing that reputation is no longer critical to success in the financial industry and tracing how this transformation occurred).

prominent, but also more isolated, such as commercials, donations, and social responsibility initiatives.[2]

We as a society are struggling with the purposes of corporate regulation and the meaning of corporate penalties. This Article contends that a return to the fundamental questions of right and wrong can offer fresh insights into these issues. And securities fraud, which has become one of the most popular ways for the government and private citizens alike to pursue corporate wrongdoing, is a sensible starting point.[3]

This Article argues that we should regard liability for civil securities fraud as a pronouncement of moral blameworthiness. Recognizing this moral dimension offers insight into how securities fraud has been developed and applied. More importantly, the morality of securities fraud can offer guidance for judges, litigants, and legislators tackling challenging issues in securities fraud today.

Of course, the role that morality plays, or should play, in law has been a fertile area of scholarly debate for many decades. The most famous of these debates is likely the 1958 exchange between H. L. A. Hart and Lon Fuller in the pages of the Harvard Law Review.[4] Hart, the legal positivist, argued in the tradition of Jeremy Bentham and John Austin that morality did not and should not play a role in understanding the law as it is.[5] Fuller, taking up the natural law mantle from forbears like Thomas Aquinas, Hugo Grotius, and Matthew

2. *See, e.g.*, Jivas Chakravarthy et al., *Reputation Repair After A Serious Restatement*, 89 ACCT. REV. 1329, 1330 (2014) (discussing successful steps accounting firms take to repair reputations after scandals); Sapna Maheshwari, *Super Bowl Commercials Feature Political Undertones and Celebrity Cameos*, N.Y. TIMES (Feb. 5, 2017), https://www.nytimes.com/2017/02/05/business/media/commercials-super-bowl-51.html [https://perma.cc/FN4K-SNCV] (highlighting Super Bowl commercials by Coca-Cola, Airbnb, and Budweiser that promoted diversity and multiculturalism, seemingly in the face of the recent executive travel ban); Devin Thorpe, *Why CSR? The Benefits of Corporate Social Responsibility Will Move You to Act*, FORBES (May 18, 2013, 5:04 PM), http://onforb.es/13D6brf [https://perma.cc/XSJ7-C5V9] (interviewing CEOs discussing the corporate benefits of CSR).

3. *See, e.g.*, Sonia A. Steinway, Comment, *SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical Analysis of the SEC's New Enforcement Approach*, 124 YALE L.J. 209, 230–32 (2014) (questioning whether rising SEC monetary penalties actually promote its core purposes).

4. *See generally* H. L. A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593 (1958); Lon L. Fuller, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630 (1958).

5. *See generally* Hart, *supra* note 4, at 594–97.

Hale, argued that law has an implicit internal morality, one that plays an important role in its application.[6]

The contours, terminology, and characters of the Hart-Fuller debate have all changed over the past sixty years, but its core points still resonate and inform legal scholarship and policy today. Criminal law scholars in particular have devoted considerable time and insight to explicating how the making of moral judgments can inform nearly every facet of law's creation, enforcement, and interpretation.[7] They have shown that a law's moral element plays one of two primary roles. First, when a moral dimension is widely recognized, its analysis can offer guidance for enhancing a law's consistency and efficacy.[8] And second, analyzing that dimension in laws that might appear morally neutral offers the additional advantage of enabling a fuller opportunity to examine, criticize, and perhaps reform the assumptions and norms the law contains.[9]

Similar, if less sizable, scholarly attention has been devoted to the moral judgments that suffuse legal rule and decision making in civil law. Such studies run the gamut in topic, approach, and conclusions, but at their core, these studies are united in their belief that taking notice of the presence (or absence) of moral underpinnings in civil laws is advantageous.[10] Be it as a descriptive or prescriptive aid (or both), understanding the role of morality can assist lawmakers in creating laws that achieve the goals they are designed for, and courts in interpreting those laws in a principled and effective manner.

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6. *See* Fuller, *supra* note 4, at 645 (outlining his theory of law and morality). *See generally* R. H. Helmholz, *Natural Law and Human Rights in English Law: From Bracton to Blackstone*, 3 AVE MARIA L. REV. 1 (2005) (providing discussion of early natural law proponents).

7. *See, e.g.*, Kyron Huigens, *Virtue and Inculpation*, 108 HARV. L. REV. 1423, 1473–77 (1995); Dan M. Kahan, *Ignorance of Law* Is *an Excuse—but Only for the Virtuous*, 96 MICH. L. REV. 127, 128–130 (1997) [hereinafter Kahan, *Ignorance of Law*]; Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 377 (1999). *But see* RICHARD A. POSNER, THE PROBLEMATICS OF MORAL AND LEGAL THEORY, at x (1999) (arguing against the use of moral theory in legal interpretation).

8. Kahan, *Ignorance of Law, supra* note 7, at 154.

9. *Id.*

10. *See, e.g.*, Thomas W. Merrill & Henry E. Smith, *The Morality of Property*, 48 WM. & MARY L. REV. 1849 (2007); William Patry, *The Role, or Not, of Ethics and Morality in Copyright Law*, 37 OHIO N.U. L. REV. 445 (2011); Phyllis Schlafly, *The Morality of First Amendment Jurisprudence*, 31 HARV. J.L. & PUB. POL'Y 95 (2008); Peter H. Schuck, *The Morality of Immigration Policy*, 45 SAN DIEGO L. REV. 865 (2008); Loren A. Smith, *The Morality of Regulation*, 22 WM. & MARY ENVTL. L. & POL'Y REV. 507 (1998). Among the most famous of such studies is Charles Fried's theory of contract law with a moral basis in what he calls "the promise principle." *See* CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 1 (1981); *see also* Charles Fried, *The Convergence of Contract and Promise*, 120 HARV. L. REV. F. 1 (2007) (offering a partially updated theory that takes into account recent economics literature).

This Article joins this tradition by examining the moral implications of civil securities fraud. The moral dimension of securities fraud developed from the offense's origins in common-law fraud and presents most prominently in securities fraud's heightened mental element requirement, scienter.[11] Recognizing this moral dimension offers both descriptive clarity about securities fraud's development and application, particularly the evolution of the private fraud action, and also prescriptive guidance for judges and litigants navigating the often fraught landscape that is securities fraud today. The moral component of securities fraud has implications for pressing questions like pleading strategies, assessments of reckless conduct, evidentiary rulings, and the threat of overcriminalization.

This Article draws on an existing body of scholarship elucidating the moral dimensions of regulatory regimes, including work on securities fraud.[12] It moves that conversation forward in a number of ways. First, the framework used to contour the moral dimension of securities fraud outlined in Part II can be used as an analytical tool in other areas of law as well, well beyond the securities laws. Second, rather than limiting itself to a single type of securities fraud or cause of action, this Article applies its framework to all causes of action in the 1933 and 1934 securities acts that address fraud and fraud-adjacent activity. This approach contrasts with the majority of work done on morality in securities law, which takes insider trading as its focus.[13] Such work is obviously valuable; insider trading has become "a [powerful] totemic symbol . . . in branding the American securities markets as supposedly open and fair."[14] But because insider trading is often a criminal action, and because of its singularity within the securities law system,[15] it is not the most effective

11. *See* Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 436–37 [hereinafter Langevoort, *Fine Distinctions*].

12. I am particularly indebted to the extensive work of Donald Langevoort and Samuel Buell on this topic.

13. *See*, *e.g.*, Stuart P. Green, *Moral Ambiguity in White Collar Criminal Law*, 18 NOTRE DAME J.L. ETHICS & PUB. POL'Y 501, 507 (2004) [hereinafter Green, *Moral Ambiguity*] (calling insider trading an offense that "even in the most hard-core cases[] is not universally viewed as morally wrongful"); Strudler & Orts, *supra* note 7, at 377 (arguing that the moral element of insider trading can be useful for hard cases); David A. Wilson, *Outsider Trading—Morality and the Law of Securities Fraud*, 77 GEO. L.J. 181, 193 (1988) (examining courts' and commentators' reliance on moral assertions in insider trading cases).

14. *See* Langevoort, *Fine Distinctions*, *supra* note 11, at 433.

15. The singularity of insider trading within securities fraud more generally consists of, among other features: action (trading) rather than speech (misrepresentations) as the focus of actionable conduct; the higher likelihood of individual, rather than corporate, prosecution; and the heightened media attention such actions receive. In addition, though the source of insider trading liability is technically Section 10(b) of the Securities Exchange Act of 1934, the contours of that liability are so

means to understand the role of morality in the securities laws more generally. This Article provides a more generalized theory of morality's place in the securities laws.

Third, and finally, this Article offers extended treatment of how judges, litigants, and legislators can use the moral dimension of securities fraud in approaching specific issues in securities law.[16] The financial collapse of 2008 and its aftermath has provided securities scholars with renewed motivation to tie their work to the securities cases in court today; this Article gladly takes up that task.

This Article proceeds in three Parts. Part II explains what it means to label a cause of action morally charged, and explores this moral dimension in traditional common-law fraud. Drawing from extensive scholarship on this topic in criminal law, this Part explains that one of the clearest ways morality can infuse civil law is when a law places prominence on the blameworthy behavior of the actor, rather than the need to compensate the victim. This Part shows that in the realm of fraud generally, it is the heightened mental element requirement, preserved in the securities laws as "scienter" or intent to deceive, that most clearly displays the laws' culpability-focused moral element.

Part III analyzes civil securities fraud more specifically so as to show the character and development of its moral dimension. It provides an overview of where fraud provisions are found in the securities laws, with particular focus on Section 10(b) of the Securities Exchange Act, the principal antifraud provision in securities litigation. It also offers historical context, showing the role that morality played in the securities laws' passage and later significant amendments, and in the Supreme Court's contouring of the Section 10(b) private cause of action.

Parts II and III having established theoretical and descriptive support for the moral dimension of civil securities fraud, Part IV then explores the ramifications and advantages of recognizing the role that dimension plays. It moves from specific pleading and evidentiary issues facing judges and litigants to more general questions of policy and legal reform involving lawmakers and the public. This Part focuses particular attention on pleadings, because of the practical reality that many securities fraud cases are either dismissed at this

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far removed from the statutory text as to be completely judicially created. *See* Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1, 30 [hereinafter Thel, *Taking Section 10(b) Seriously*].

16. My focus is primarily how this moral dimension can inform decision rules, which are directed at those in the legal system and address how to decide legal questions. Conduct rules, which are directed at society at large and address proper behavior, is a separate question this Article does not address. *See* Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 2039 (2006) [hereinafter Buell, *Novel Criminal Fraud*].

stage or settle shortly thereafter, and on the concept of recklessness. The moral dimension of securities fraud can offer judges a helpful lens by which to assess hard questions of intent, along with confidence that their rulings align with the purposes of the securities fraud and a less burdensome caseload in the longer term. It can offer plaintiffs new avenues to pursue their objectives most efficiently, and defendants new ways to present their defenses most convincingly. It can offer lawmakers a foundation upon which to amend the securities laws moving forward, and the corporate community new ideas for how to prevent fraud.

II. CIVIL SECURITIES FRAUD AS MORAL JUDGMENT

That civil securities fraud has a moral element is not intuitive. Nor is it intuitive that a law's moral element should play any role in jurisprudence, even if one recognizes its presence.[17] This Part explores the contours of civil securities fraud's moral dimension: its deontological emphasis on the wrongful, blameworthy behavior of the perpetrator independent of its outside consequences.[18] This dimension, clear in criminal law, inhabits many areas of civil law as well.

This Part uses scholarship from criminal law to explore a moral dimension tied to culpability, and offers two elemental indicators for when that dimension might be present in civil law as well: the presence of punitive damages and a heightened mental element requirement.

This Part continues by moving from the general to the specific and looking at fraud in the common law. Traditional fraud has a clear moral dimension, one that manifests most tellingly in its mental element requirement. Fraud's immorality rests in its nature as deception, a link largely preserved in securities fraud causes of action today. It will be the work of the remaining Parts to show how the moral dimension of traditional fraud is retained in modern civil securities fraud and how it affects that law today.

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17. *See* POSNER, *supra* note 7, at x.

18. This is not to say that morality does not play a role in other ways—it certainly does. In particular, Michael Moore points out an equally robust moral dimension of criminal law to culpability that he labels "wrongdoing," which is focused on the act rather than the perpetrator. *See* Michael S. Moore, Prima Facie *Moral Culpability*, 76 B.U. L. Rev. 319, 320–21 (1996). This distinction will not be taken up in this Article, but Moore's theories of wrongdoing are fertile ground for advancing the inquiry some scholars have started—how the causation showing of securities fraud (and other types of fraud) has moral implications. *See, e.g.*, Strudler & Orts, *supra* note 7, at 385.

A. What Does It Mean to Call a Law Morally Charged?

1. A Focus on the Wrongful Perpetrator, Not the Wronged Victim

When considering the moral dimension of the law, criminal law is the obvious starting point. It is widely recognized that criminal law includes a moral element, that criminal charges denounce the proscribed activity as not only harmful, but wrongful.[19] Criminal law is characterized by, among other things, the severity of its sanctions (including the possibility of imprisonment), the presence of the state as a party rather than the individual victim, and the existence of a permanent criminal record.

A principal purpose of criminal punishment is deterrence, the prevention of future bad behavior.[20] But another component is retribution or just deserts, which justifies punishment as an expression of community outrage and an appeal to notions of fairness and justice.[21] Criminal punishment condemns the perpetrator for contravening established social norms, and so much of the moral weight of criminal law results from its inquiry into the culpability of the defendant him or herself.[22] "Culpability focuses on the actor, not on the act . . . ."[23]

This understanding of morality is deontological rather than utilitarian. That is, the morality expressed in culpability in criminal law is not tied solely to an act's consequences; the act itself can be declared wrong without primary reference to objective harm that it might produce in comparison with another

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19. *See* Stuart P. Green, *Lying, Misleading, and Falsely Denying: How Moral Concepts Inform the Law of Perjury, Fraud, and False Statements*, 53 HASTINGS L.J. 157, 159 (2001) [hereinafter Green, *Lying*] ("Even those writers . . . who reject legal moralism in the [old] sense, agree that conduct must be more than merely harm-producing in order to be criminalized; it must also involve some form of moral wrongfulness."); Dan M. Kahan, *Social Influence, Social Meaning, and Deterrence*, 83 VA. L. REV. 349, 363 (1997) [hereinafter Kahan, *Social Influence*] (writing that criminal law "can *express* meanings directly by taking positions that, in the context of extant social norms, signify particular valuations"). Of course, there is also robust conversation surrounding overcriminalization, including a concern that the government is criminalizing behavior that lacks moral blameworthiness. *See, e.g.*, Paul J. Larkin Jr., *A Mistake of Law Defense as a Remedy for Overcriminalization*, 28 CRIM. JUST. 10, 10–13 (2013). I will return to this concern in Part IV.

20. *See, e.g.*, Kahan, *Social Influence*, *supra* note 19.

21. *See* Richard S. Frase, *Punishment Purposes*, 58 STAN. L. REV. 67, 69–75; *see also* Paul H. Robinson, *Criminal Law Defenses: A Systematic Analysis*, 82 COLUM. L. REV. 199, 243–44 (1982) (distinguishing four primary aims to criminal liability—"just punishment, general deterrence, special deterrence, and rehabilitation"—and explaining that just punishment involves "the public condemnation of the offender and his conduct").

22. *See* Kahan, *Social Influence, supra* note 19, at 384.

23. Moore, *supra* note 18, at 319.

course of action.[24] Traditional deontologists have no qualms about declaring what is "right" without reference to what is beneficial.[25]

That is not to say that we are justified in criminalizing behavior simply because it violates a notion of inherent morality. That line of argument, found in traditional legal moralism, often leads down deeply problematic paths.[26] And indeed, scholars point out that retributive and condemnatory punishment can have utilitarian results, such as reinforcing respect for the law and thus encouraging general adherence.[27] But that does not mean that strict harm prevention is the only justification for criminalization, or that failure to identify a utilitarian result necessitates the elimination of punishment.[28] The lesson retained from traditional legal moralism is that applying the law necessitates the making of moral judgments, even if actors in the law are ambivalent about acknowledging such moralizing.[29]

In contrast, the civil law system's principal purpose has long been recognized as being to compensate, not condemn.[30] The focus is not on the perpetrator and what she did wrong, but rather, on the harm suffered by the victim and to what extent he deserves compensation.[31] Traditional civil law is the law of the private action, where individuals can avail themselves of the legal system to make themselves whole.[32] Civil law "prices"; "criminal law prohibits."[33]

It bears emphasizing that this division between criminal punishment and civil compensation speaks only to the primary focus of each type of law—the

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24. *See* MICHAEL J. SANDEL, LIBERALISM AND THE LIMITS OF JUSTICE 1–3 (1982).

25. *Id.*; ALAN DONAGAN, THE THEORY OF MORALITY 17–31 (1977).

26. *See generally* 4 JOEL FEINBERG, THE MORAL LIMITS OF THE CRIMINAL LAW: HARMLESS WRONGDOING 124–75 (1988). The rise and fall of sodomy and blasphemy laws offer good illustrations. *See id.* at 126–27.

27. *See* Robinson, *supra* note 21, at 243–44.

28. That would be the argument of legal moralism's traditional alternative, liberalism. *See* Jeffrie G. Murphy, *Legal Moralism and Liberalism*, 37 ARIZ. L. REV. 73, 75 (1995).

29. *See* Kahan, *Ignorance of Law*, *supra* note 7, at 153.

30. *See* John C. Coffee, Jr., *Does "Unlawful" Mean "Criminal"?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 193–94 (1991) [hereinafter Coffee, *Unlawful*]; Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law*, 101 YALE L.J. 1795, 1796 (1992).

31. *See* Coffee, *Unlawful*, *supra* note 30, 193–94.

32. *See id.*

33. *Id.* at 194. *See generally* Jerome Hall, *Interrelations of Criminal Law and Torts: I*, 43 COLUM. L. REV. 753 (1943) (parsing the traditional distinctions between civil and criminal law with focus on the moral component of the latter); Jerome Hall, *Interrelations of Criminal Law and Torts: II*, 43 COLUM. L. REV. 967 (1943) (same).

"dominant tendency" that explains their elements and structure.[34] This is not to say that criminal law never concerns itself with compensating those wronged, or that civil law never has a punitive component. Quite the contrary, there is a robust model of restitution in our criminal law system, and countless examples of sanction and condemnation in the civil. In other words, our legal system is no longer (and likely never was) one where blameworthiness mandates criminal sanctions.[35]

Even more importantly, certain areas of law have long been recognized as inhabiting a middle ground between civil and criminal law where the traditional divisions break down. So-called "hybrids" are commonly found in regulatory statutes where "precisely the same conduct can give rise to either criminal or civil penalties," based largely on prosecutorial discretion.[36] The charging question often hinges in part on an assessment not only of how culpable the activity is, but also the most effective way to deter others from similar actions in the future.[37] Indeed, while deterrence sometimes goes by other names in the civil realm, there is no doubt that many civil laws have deterrence as a primary goal—not least regulatory schemes.[38] In 2017, the Supreme Court held that one purpose of SEC-brought civil securities cases is deterrence, which can only be a punitive government objective.[39]

Civil actions with a moral dimension do still focus on compensation. However, they also integrate features of the criminal law. In determining liability under these actions, it is not only harm to the victim that is assessed, but also culpability—the blameworthiness of the perpetrator.[40] Liability often comes with an enhanced dimension of punishment, as well as a heavy dose of societal condemnation.[41] In other words, violators of civil actions with a moral dimension are deemed not just liable, but wrongful.[42]

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34. *See* Coffee, *Unlawful*, *supra* note 30, at 194 n.4.

35. *See id.* at 213.

36. *See* Green, *Moral Ambiguity*, *supra* note 13, at 514; *see also* John C. Coffee, Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models—And What Can Be Done About It*, 101 YALE L.J. 1875, 1879 (1992); Coffee, *Unlawful*, *supra* note 30, at 201.

37. *See* Coffee, *Unlawful*, *supra* note 30, at 224.

38. The presence of deterrence as a stated goal is so prevalent in civil law these days that it is a poor gauge by which to measure the presence of a moral dimension. Ultimately, how society views the behavior being deterred is what signals a moral element, rather than the presence of a deterrent goal itself.

39. *See* Kokesh v. SEC, 137 S. Ct. 1635, 1643–44 (2017).

40. Coffee, *Unlawful*, *supra* note 30, at 211.

41. *Id.* at 201.

42. *Id.*

2. Identifying Civil Actions with a Moral Dimension

Just as the division between criminal and civil is often blurrier than first appears, the division between morally charged and morally neutral actions can be hard to define. Often, the moral element of a civil law is more a question of degree than of kind.[43] Nor is this division static. As society's attitudes and priorities change, something that was once a relatively neutral regulatory matter can transform into something that violates fundamental community standards, and, consequently, moral condemnation begins to play a heightened role in its enforcement.[44] And just as this Article draws attention to an area of law that others may dismiss as morally neutral, there are moral dimensions to many areas of law that may not be initially obvious.[45]

That being said, there are certain signals that a law has a moral dimension premised on the culpability of the perpetrator, and that this dimension plays a role in the law's application. I offer two. While neither feature is necessary or sufficient to deem a cause of action morally charged in this way, they are both good indicators that something more than compensation is at play, and that identifying this background player might prove helpful in elucidating the law.

The first and most obvious indicator of a moral dimension to a civil law is the availability of punitive remedies: sanctions, fines, and damages. Punitive damages in particular, designed to implement many of the same purposes as criminal punishment, are widely recognized as carrying moral censure.[46] Punitive damages feature prominently in common law as well as in federal statutes.[47] Other sanctions, like suspension or revocation of a license or registration, tend only to be available when the government brings the action,

43. *Id.* at 238–39.

44. *Id.* (offering unlawful toxic dumping as one such example).

45. Indeed, one would be hard pressed to find a law for which it would be impossible to argue that moral implications exist. *But see* Kahan, *Ignorance of Law, supra* note 7, at 146–47 (arguing that criminal tax provisions do not embody moral norms independent of the law itself); Jacob S. Sherkow, *Patent Infringement as Criminal Conduct*, 19 MICH. TELECOMM. & TECH. L. REV. 1, 10 (2012) (arguing that patent law is devoid of moral purposes).

46. *See, e.g.*, Exxon Shipping Co. v. Baker, 554 U.S. 471, 490–92 (2008) (discussing the roots of punitive damages as being in part "justified as punishment for extraordinary wrongdoing"); BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 575 (1996) (measuring appropriateness of punitive damages against "the degree of reprehensibility of the defendant's conduct").

47. *See, e.g.*, 15 U.S.C. § 15(a) (2012) (mandating treble damages for certain antitrust violations); 18 U.S.C. § 1964(c) (2012) (mandating treble damages for racketeering violations); *see also* Mann, *supra* note 30, at 1796–98 (discussing punitive damage awards under common law and federal statutes).

which emphasizes the public interest in the case and that social norms are being contravened.[48]

The second indicator of a moral dimension to a civil law is the presence of a heightened mental element requirement. The criminal corollary is mens rea—the "guilty mind" requirement.[49] One of the three principal functions of the mens rea requirement is "to ascribe a level of moral blameworthiness to a defendant who commits a particular act."[50] Just as a finding of mens rea leads to criminal culpability, so too is the presence of a heightened mental element in a civil action a good indication that liability will be accompanied by a declaration of culpability, which, as explained above, is "a transparently moral concept,"[51] and by extension a moral judgment. A heightened mental element requirement plays a critical role in identifying morally charged sections of the securities laws, an exercise that will be undertaken in Part III.

B. The Traditional Moral Dimension of Fraud

There is another important way to identify a law's moral dimension, and that is to look to its origins. Whether they be common law or statutory, most laws have at least one clear ancestor from which they either naturally evolved or were intentionally fashioned.[52] And while the end product may differ dramatically from the parent, certain features do linger in unexpected ways, including, often, a moral element.

Unlike the indicators discussed in the previous Section, looking at a law's origins for the presence of a moral dimension is necessarily an individualized

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48. *See* Kokesh v. SEC, 137 S. Ct. 1635, 1643–44 (2017) ("[W]hether a sanction represents a penalty turns in part on 'whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual.'" (quoting Huntington v. Attrill, 146 U.S. 657, 668 (1892))).

49. Green, *Moral Ambiguity*, *supra* note 13, at 512.

50. Sherkow, *supra* note 45, at 12. The other two principal functions are (1) "to differentiate between those acts requiring private compensation . . . as opposed to societal retribution," *id.*, and (2) "to shield people against punishment for apparently innocent activity." *Id.* (quoting Staples v. United States, 511 U.S. 600, 622 (1994) (Ginsburg, J., concurring)). The fact that the presence of mens rea can establish blameworthiness is one reason why courts and legislators alike are so eager to read or insert mental elements into crimes where the moral wrongfulness is not immediately apparent; there is latent discomfort in criminalizing behavior that is not obviously wrongful. *See* Green, *Moral Ambiguity*, *supra* note 13, at 512; John Shepard Wiley Jr., *Not Guilty by Reason of Blamelessness: Culpability in Federal Criminal Interpretation*, 85 VA. L. REV. 1021, 1022–23 (1999).

51. *See* Strudler & Orts, *supra* note 7, at 385 n.35. *But see* Sherkow, *supra* note 45, at 39–41 (warning against reading moral condemnation into civil mental state requirements where it is not aligned with statutory purpose).

52. *See, e.g.*, STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690–1860, at 1–2 (1998) (introducing centuries of securities regulation that informed twentieth-century American securities laws).

exercise. This Section focuses on one source of civil securities fraud—common-law fraud—to illustrate this larger analytical point, and also to provide specific support for this Article's main argument. Common-law fraud contains a moral element inherently tied to the mental state of the accused, and that element is preserved in securities fraud today.

The moral dimension of fraud predates its codified illegality. Dante devoted the entire Eighth Circle of Hell to those who committed fraud (*frode*), its position indicating that he considered only traitors more blameworthy.[53] Fraud, at its core, is a type of deception, and it is that deception that encapsulates fraud's immorality.[54] To deceive is to infringe on another's autonomy: to willfully alter another's mental processes by skewing the truth.[55] Whether the deception leads to material harm is irrelevant from a deontological point of view; the deception itself is the wrong committed.[56]

Fraud's development from sin to legal wrong closely tracks commercial development generally. Early common law strongly promoted *caveat emptor*, expecting consumers to exercise prudence to prevent themselves from being cheated.[57] It was only after commercial transactions became increasingly complex in the seventeenth century that courts and lawmakers began to recognize the need for more comprehensive and flexible definitions of liability.[58] The new laws needed to account both for customers' current vulnerability and for the practical reality that more innovative fraudulent practices were always in development.[59] This ultimately led to the broad fraud causes of action we know today.[60]

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53. *See* DANTE ALIGHIERI, LA DIVINA COMMEDIA—INFERNO Cantos XI, XVIII-XXX (La Nuova Italia 3d ed. 1985). Dante conceived of hell as a pit of nine concentric circles, each punishing a different kind of sinner. The circles were ordered from least to most blameworthy, with the deepest, the Ninth Circle of Hell, reserved for traitors like Judas Iscariot. *Id.* at Cantos XXXII-XXXIV.

54. *See* Commonwealth v. Tuckerman, 76 Mass. (10 Gray) 173, 203 (1857) ("In fraud there is always some kind of deception."); Strudler & Orts, *supra* note 7, at 408.

55. *See* James Edwin Mahon, *A Definition of Deceiving*, 21 INT'L J. APPLIED PHIL. 181, 181 (2007); *see also* Thomas E. Hill, Jr., *Autonomy and Benevolent Lies*, 18 J. VALUE INQUIRY 251, 256, 265 (1984) (highlighting the link between deception and autonomy). For additional discussion on the immoral nature of deception, see CHARLES FRIED, RIGHT AND WRONG 54–78 (1978) and Joseph Kupfer, *The Moral Presumption Against Lying*, 36 REV. METAPHYSICS 103 (1982).

56. The immorality of interfering with autonomous choices also aligns with much utilitarian theory. *See* FRIED, RIGHT AND WRONG, *supra* note 55, at 33, 60.

57. Green, *Lying*, *supra* note 19, at 160.

58. *Id.*

59. *See* Buell, *Novel Criminal Fraud*, *supra* note 16, at 1972–73, 1988.

60. *Id.*; Green, *Lying*, *supra* note 19, at 183–85.

There can be no deception without intent to deceive.[61] Therefore, it should come as no surprise that one of the key elements of a fraud claim traditionally was evidence of wrongful intent.[62] Since the specific actions that amounted to fraud were constantly evolving, wrongful intent was a way to proscribe various forms of fraudulent activity with a single law without it becoming dangerously overbroad.[63] The Supreme Court recently confirmed the moral dimension of nineteenth-century fraud and its link to intent in construing the term "actual fraud" in the Bankruptcy Code:

> "Actual fraud" has two parts: actual and fraud. The word "actual" has a simple meaning in the context of common-law fraud: It denotes any fraud that "involv[es] moral turpitude or intentional wrong." "Actual" fraud stands in contrast to "implied" fraud or fraud "in law," which describe acts of deception that "may exist without the imputation of bad faith or immorality." Thus, anything that counts as "fraud" and is done with wrongful intent is "actual fraud."[64]

Actual fraud's traditional association with moral turpitude was heavily tied into its intent element.

This is not to say that every fraud action in our law today retains a moral dimension. Even within the securities laws there are provisions designed to prevent fraud that lack a heightened mental element and, consequently, are much more distanced from moral condemnation. The presence of implied and constructive fraud actions, as well as other types of misrepresentation actions, reflect a widespread understanding in our law that there are reasons other than moral condemnation to label something fraud and to attach liability.[65]

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61. Green, *Lying*, *supra* note 19, at 163.

62. *See id.* at 160–63.

63. *See id.* at 183–85.

64. Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1586 (2016) (alteration in original) (citations omitted) (quoting Neal v. Clark, 95 U.S. 704, 709 (1878)); *see also* Robert A. Prentice, Stoneridge, *Securities Fraud Litigation, and the Supreme Court*, 45 AM. BUS. L.J. 611, 622 (2008) (pointing out that when Congress passed the securities laws in the 1930s, "*virtually every existing body of fraud jurisprudence imposed liability upon those who* knowingly participated *in a fraud*"). Seminal fraud opinions from the United Kingdom from the same period as *Neal* also required the showing of a "wicked mind" for fraud liability to attach. *See* Le Lievre v. Gould [1893] 1 QB 491 at 498 (Eng.) (discussing Derry v. Peek [1889] 14 HL 337); *see also* William H. Kuehnle, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121, 154 (1997) (citing Derry v. Peek [1889] 14 HL 337 at 347) (explaining the Derry opinion as one where "the House of Lords held that in an action for deceit, the false statement must be made fraudulently, that is, with some element of moral dishonesty").

65. For example, reasons for the constructive fraud cause of action include preventing wrongdoers from benefitting from those wrongs, regardless of intent, and promoting good faith

However, those types of fraud that do have a heightened intent requirement align closely with traditional common-law fraud, and so bring with them the same moral condemnation.[66]

When the civil law departs from its traditional goal of victim compensation and moves instead toward a focus on an individual's culpable behavior, it leaves the realm of pure moral neutrality. Liability and punishment under such laws have a moral dimension, recognized or otherwise, and the presence of punitive damages or a heightened mental element requirement are both good indicators that this threshold has been crossed. In the case of common-law fraud, the heightened mental element ties civil fraud to its origins as sinful behavior premised on deceit, and thus embodies the moral dimension of the misconduct. The next Part will show to what extent traditional fraud's origins play a role in securities fraud today.

III. CIVIL SECURITIES FRAUD AS MORALLY CHARGED

Civil securities fraud is morally charged. Finding someone liable for securities fraud is not just about compensation, but about condemnation and punishment. Judges and juries look not just to whether a victim was harmed, but whether a perpetrator deceived.[67] Liability is gauged not just with reference to the harm done to individual victims, but the harm done to the public as a whole through the wrongful contravention of established social norms.[68] Using the securities laws to find someone liable reflects the public's commitment to a background of political morality, and brings with it a judgment that the wrongdoer's actions have offended that morality.

This Part takes as its focus the moral dimension of civil securities fraud in the context of both the present securities laws and their statutory and jurisprudential history. It begins by identifying what constitutes securities fraud and where the relevant causes of action can be found within the securities laws. This exercise emphasizes those securities actions that require a showing of

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conduct in business dealings. *See* Jeffrey A. Monhart, *A Primer on the Developing Doctrine of Constructive Fraud in Montana*, 52 MONT. L. REV. 153, 155–56 (1991).

66. Suggesting such a high threshold for actionable core fraud is not undisputed. In the securities context, for instance, Donald Langevoort asserts that a speaker's awareness of falsity (and not a motive to mislead) is all that is required for a finding of securities fraud. *See* Donald C. Langevoort, *Reflections on Scienter (and the Securities Fraud Case Against Martha Stewart that Never Happened)*, 10 LEWIS & CLARK L. REV. 1, 5–10 (2006) [hereinafter Langevoort, *Martha Stewart*]. It is likely that we are in closer agreement than might first appear, particularly given that Langevoort's focus is insider trading. *See id.* at 6 & n.16 (appearing to include intent to deceive in his definition of awareness).

67. *See, e.g.*, Kuehnle, *supra* note 64, at 148.

68. *See, e.g.*, Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1117 (2008).

scienter, i.e., a knowledge of wrongdoing, for liability to attach. The scienter element can be used to parse which sections of the securities laws constitute morally charged fraud.

This Part then looks to the historical context of the securities laws' passage and later significant amendments, as well as the Supreme Court cases that contoured securities fraud into what we know it as today. This history shows that while the moral dimension of securities fraud was not an inevitable product of these events, the passage of the securities laws was certainly morally fraught, and the fraud provisions, as ultimately construed by the Supreme Court, have become an expression of that moral dimension.

A. What is Securities Fraud?

Just as arguing that a law contains a moral dimension necessitates contouring that dimension, arguing that civil securities fraud contains a moral dimension necessitates a particular understanding of what the term "civil securities fraud" encompasses. Different sources label "antifraud" provisions in the securities laws differently, and only some such provisions have a pronounced moral dimension under the reasoning elucidated in Part II.

This Section begins by offering a brief overview of the principal securities fraud provision, Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 promulgated thereunder.[69] These two texts are the bases of most securities fraud actions, and heavily inform our understanding of securities fraud in other sections of the securities laws. Unsurprisingly, one element of a Section 10(b) fraud action is scienter, "a mental state embracing intent to deceive, manipulate, or defraud."[70]

The presence of a heightened mental element requirement like scienter is the simplest way to identify that subset of securities fraud provisions which is morally charged. It is this heightened mental element that reflects a culpable state of mind and, by extension, moral judgment.[71] Only those causes of action that require scienter or a similar mental component reflect the type of moral judgment with which this Article concerns itself, and so "civil securities fraud" refers only to those actions. Other sections of the securities laws may be labeled "antifraud" in other settings and for other purposes, but they lack a heightened mental element and, consequently, the moral dimension under discussion here. This Section also offers a preliminary consideration of the Securities and

69. 15 U.S.C. § 78j(b) (2012); 17 C.F.R. § 240.10b-5 (2017).

70. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976).

71. The other indicator from the previous Part, punitive damages, will also be discussed. *See supra* Section II.A.2; *infra* Section III.A.3.

Exchange Commission's (SEC) role in securities litigation as an expression of public mores.

1. Section 10(b) and Rule 10b-5

When scholars or practitioners discuss securities fraud, first and foremost, they mean actions brought under Section 10(b) of the Securities Exchange Act of 1934, and SEC Rule 10b-5 promulgated thereunder.[72] These two passages, the focus of so much attention, are surprisingly short. Section 10(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[73]

The meaning of "any manipulative or deceptive device or contrivance" has been of particular significance in later case law, as discussed below.[74]

Section 10(b) can be violated only derivatively; for liability to attach, there must exist "rules and regulations" prescribed by the SEC and contravened by the defendant.[75] The primary of these rules is Rule 10b-5, enacted in 1942 and designed to encompass as broad a scope as allowable under Section 10(b).[76] It states in full:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national

72. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. I refer throughout this Article to cases or claims brought under Section 10(b) or Rule 10b-5 as "Section 10(b)" cases or claims.

73. 15 U.S.C. § 78j.

74. *See infra* Section III.B.2.

75. 15 U.S.C. § 78j(b).

76. *See* 3 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 541–42 (Thomas Reuters 7th ed. 2016); *see also* Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formation*, 47 WASH. & LEE L. REV. 527, 530–31 (1990) [hereinafter Langevoort, *SEC*] (criticizing the SEC for continuing to avoid adopting bright-line rules to keep its jurisdictional scope at a maximum).

> securities exchange,
>
> (a) To employ any *device, scheme, or artifice to defraud*,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would *operate as a fraud or deceit* upon any person, in connection with the purchase or sale of any security.[77]

Again, the phrases "device, scheme, or artifice to defraud" and "operate as a fraud or deceit" will be important moving forward.[78]

Neither the statute nor the administrative rule spell out the elements of a cause of action for securities fraud. Instead, these sections have spawned one of the largest judicially created bodies of federal law. Chief Justice Rehnquist called Rule 10b-5 "a judicial oak which has grown from little more than a legislative acorn."[79] For both the statute and the administrative rule, the elements are the same. Those bringing a section 10(b) private suit must prove, in connection with the sale or purchase of a security:

(1) that the defendant made a materially false statement or omission;
(2) that the defendant acted with scienter;
(3) that the plaintiff relied on the misrepresentation or omission;
(4) that the plaintiff suffered economic loss; and
(5) that the plaintiff's loss was caused by the material misstatement or omission.[80]

When bringing section 10(b) actions, the SEC does not need to prove the last three elements for liability to attach.[81]

2. Other Provisions of the Securities Laws

In addition to Section 10(b) actions, scienter is also an element in a number of other actions brought under the Securities Act of 1933 and Securities

77. 17 C.F.R. § 240.10b-5 (2017) (emphasis added).

78. *See infra* Section III.A.2.

79. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

80. *See* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005).

81. *See* Aaron v. SEC, 446 U.S. 680, 691 (1980); SEC v. Rind, 991 F.2d 1486, 1490 (9th Cir. 1993).

Exchange Act of 1934.[82] These include, most prominently, Section 17(a)(1) of the Securities Act of 1933, which prohibits the employment of "any device, scheme, or artifice to defraud" in connection with the offer or sale of securities.[83] Section 17(a) is in many ways the Securities Act equivalent of Section 10(b), but the Supreme Court has held that only the first subsection requires scienter.[84]

Additional securities actions that require scienter or a similar mental component include private actions under Section 9(a) of the Exchange Act,[85] which prohibits creating the false impression of active trading,[86] Section 14(e) of the Exchange Act,[87] which prohibits misstatements and fraud in connection with tender offers,[88] and Section 15(c)(7) of the Exchange Act,[89] which prohibits the knowing or willful making of false written statements in connection with the offer or sale of government securities.[90] Section 18 of the Exchange Act,[91] which prohibits false filings, makes it the defendant's responsibility to show a lack of culpable mind, and so also involves scienter, albeit with a burden shift.[92]

Other sections of the securities laws that are often described as antifraud provisions lack a scienter requirement and so lack the moral dimension this

82. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa); Securities Exchange Act of 1934 (1934 Act), Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78oo).

83. 15 U.S.C. § 77q(a)(1) (2012).

84. *See Aaron*, 446 U.S. at 697.

85. 15 U.S.C. § 78i(a)(1).

86. *See id.*; AnchorBank, FSB v. Hofer, 649 F.3d 610, 616 (7th Cir. 2011); Connolly v. Havens, 763 F. Supp. 6, 11 (S.D.N.Y. 1991); *see also* GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 203 (3d Cir. 2001) (comparing Section 9(a)'s provisions to 10(b)'s). Section 9(f), 15 U.S.C. § 78i(f) (formerly Section 9(e)), creates a private right of action against anyone who "willfully" violates Sections 9(a)–(c). The Supreme Court has indicated this language constitutes a scienter requirement. *See* Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau, 508 U.S. 286, 295–96 (1993) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 209 n.28 (1976)); *see also* Ray v. Lehman Bros. Kuhn Loeb, Inc., 624 F. Supp. 16, 19 (N.D. Ga. 1984) (including scienter as a requirement under Section 9(e)).

87. 15 U.S.C. § 78n(e).

88. *See In re* Digital Island Sec. Litig., 357 F.3d 322, 328 (3d Cir. 2004).

89. 15 U.S.C. § 78o(c)(7).

90. This section was added in 1993 as part of the Government Securities Act Amendments, Pub. L. No. 103-202, § 110, 107 Stat. 2344, 2353 (1993), and does not appear to have been used in any federal court decision.

91. 15 U.S.C. § 78r(a).

92. *See* Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau, 508 U.S. 286, 296 (1993) (stating that Section 18 "involve[s] defendants who have violated the securities law with scienter"); Dekalb Cty. Pension Fund v. Transocean Ltd., 817 F.3d 393, 405–06 (2d Cir. 2016) (holding that Section 18(a) requires knowing misrepresentation).

Article analyzes. For example, scienter is not currently understood to be required for liability under Sections 17(a)(2)–(3) of the Securities Act, which prohibit "obtain[ing] money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading" and "engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser" in connection with the offer or sale of securities.[93] Nor is scienter required for liability under Sections 11 and 12(a)(2) of the Securities Act, which prohibit false or misleading statements in certain securities filings.[94] Liability attaches under Section 11 to registration statements "contain[ing] an untrue statement of a material fact or omitt[ing] to state a material fact required to be stated therein or necessary to make the statements therein not misleading,"[95] while Section 12(a)(2) proscribes prospectuses and oral communications used to sell securities that "include[] an untrue statement of a material fact or omit[] to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."[96]

This division, between moral and amoral, scienter and no scienter, closely tracks one made in fraud scholarship generally, which contrasts so-called "core" fraud actions with lesser types of misrepresentation, where liability still attaches, but not the same condemnation.[97] Core fraud actions are more closely aligned with traditional common-law fraud, whose moral dimension was explored in Part II.[98] Misrepresentation actions move further away from that origin, and consequently generally do not require an intent showing.[99]

Dividing securities fraud actions according to scienter requirements is not completely neat. For one, what constitutes fraud for the purposes of the Private Securities Litigation Reform Act (PSLRA)[100] does not turn on the requisite

93. 15 U.S.C. §§ 77q(a)(2)–(3).

94. *Id.* §§ 77k(a), 77*l*(a)(2). In addition, Section 12(a)(1), *id.* § 77*l*(a)(1), offers damages to those who purchase securities from defendants who did not comply with the registration or prospectus requirements of the Act. It is widely understood as a strict liability action, and so is not popularly considered an antifraud provision. *See* Pinter v. Dahl, 486 U.S. 622, 638 (1988).

95. 15 U.S.C. § 77k(a).

96. *Id.* § 77*l*(a)(2). There are other causes of action under the securities laws, notably under Sections 16 and 20 of the Exchange Act, but since these tend not to be considered fraud provisions they will not be discussed.

97. *See* Samuel W. Buell, *What is Securities Fraud?*, 61 DUKE L.J. 511, 526–40 (2011) [hereinafter Buell, *What is Securities Fraud?*].

98. *Supra* Part II.

99. Buell, *What is Securities Fraud?*, *supra* note 97, at 532.

100. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

mental element. The PSLRA, which applies to private securities class actions, provides its own description of what constitutes "securities fraud actions," and that description closely tracks the misrepresentation language of Sections 11 and 12(a)(2) and does not include mention of a mental element.[101] Instead, the PSLRA implies that actions requiring "proof that the defendant acted with a particular state of mind" form a subset of securities fraud actions.[102]

Furthermore, the scienter requirements of various sections of the securities laws are usually not clear from the statutory language. In many instances, case law is the source of the scienter requirement.[103] This can make it difficult to determine whether a scienter requirement is always necessary under a particular provision or only under certain circumstances (such as private actions versus administrative actions), and also means that the scope of securities fraud's moral dimension is not static; it changes as additional provisions come under scrutiny.[104]

These challenges do not mean that the exercise of focusing on securities actions with a scienter element is futile. The inconsistency raised by the PSLRA is one of nomenclature rather than substance. What counts as fraud for purposes of pleading does not preclude a subset of morally charged actions within it.[105] We have already seen that fraud is itself a dynamic concept, evolving to encompass behavior as it is deemed wrongful by society.[106] Indeed, one reason that Rule 10b-5 continues to be used is its unusual ability to adapt to changing social understandings and norms regarding the securities industry.[107] That courts might continue to elucidate new places where a mental

101. *See id.* § 21D(b)(2), 109 Stat. at 746–47; 15 U.S.C. § 78u-4(b)(1) (describing the actions the section covers as those "in which the plaintiff alleges that the defendant- (A) made an untrue statement of a material fact; or (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading").

102. *See* Private Securities Litigation Reform Act § 21D(b)(2), 109 Stat. at 746–47; 15 U.S.C. § 78u-4(b)(2)(A) (stating that such actions require that the plaintiff "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"). This stands in contrast with Federal Rule of Civil Procedure 9(b), which provides heightened pleading requirements for allegations of fraud, but specifically states that "conditions of a person's mind may be alleged generally" rather than "with particularity." FED. R. CIV. P. 9(b).

103. *See, e.g.*, Dekalb Cty. Pension Fund v. Transocean Ltd., 817 F.3d 393, 405–07 (2d Cir. 2016); *see also* Private Securities Litigation Reform Act § 21D(b)(2), 109 Stat. at 746–47.

104. For instance, the scienter element of Section 18(a) was only recently elucidated in the Second Circuit. *See DeKalb Cty. Pension Fund*, 817 F.3d at 405–07.

105. *See* 15 U.S.C. § 78u-4(b).

106. Buell, *Novel Criminal Fraud*, *supra* note 16, at 1976; *see also supra* Section II.B.

107. *See* Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. S7, S7–S8 (1993) [hereinafter Langevoort, *Rule 10b-5*].

element plays a role, and thus where a moral dimension rests, only reinforces this point.[108]

3. SEC Enforcement Actions

SEC-brought securities fraud actions present an interesting category for the purpose of examining the securities laws' moral dimension. On the one hand, the scienter analysis this Section offers is true regardless of whether an agency or private party brings the action, suggesting the participation of the SEC is irrelevant to the morality assessment. On the other hand, SEC involvement suggests even more moral questions are at play than in a pure private action.

Governmental participation in a civil action often highlights a public interest in preventing the action at issue,[109] aligning it more closely to the social norm preservation goals of criminal law. Admittedly, the ever-expanding regulatory regime—along with differing societal values attached to the behavior under examination—makes government participation generally a poor indicator of a moral element at play.[110] But in the case of the SEC, its stated goals of protecting investors and the integrity of the markets take on a distinctly moral sheen.[111]

The SEC's role in securities fraud offers a few particular features. For instance, punitive damages are generally not available for securities fraud unless coupled with another statute allowing them, like the Racketeering Influenced and Corrupt Organizations Act (RICO).[112] However, the SEC is allowed to impose civil fines in some instances, including, notably, for willful

108. It should be noted that when courts hold that a mental element requirement is present, it tends to narrow, rather than broaden, the original cause of action. In other words, fewer people become liable under the clarification, rather than more. For instance, see Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976), whose holding that scienter was a requisite element of Section 10(b) actions ultimately resulted in the dismissal of the suit against the defendant. Thus, as with the mental element requirement in traditional fraud, scienter in securities fraud avoids the potential problem of defendants being found liable under uncertainly drawn lines.

109. *See, e.g.*, Kokesh v. SEC, 137 S. Ct. 1635, 1643 (2017); United States v. Borden Co., 347 U.S. 514, 518–19 (1954).

110. *See supra* text accompanying note 38.

111. *See What We Do*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/about/whatwedo.shtml [https://perma.cc/9TH9-CTND] (last visited Dec. 20, 2017). Of course, the SEC's focus on investment protection could also be read the other way, as highlighting the compensatory nature of securities fraud. For instance, since the Sarbanes-Oxley Act, the Commission has the power to use monetary judgments, including punitive ones, to compensate victims. *See* Winship, *supra* note 68, at 1118–21.

112. *See* 18 U.S.C. § 1964(c) (2012) (stating those suing under RICO "shall recover threefold the damages [they] sustain[]," though noting that securities fraud itself cannot establish a RICO violation).

violation of the securities laws.[113] Penalties, when they are available, increase based on factors that could be read as linked to levels of culpability, and consequently, moral judgment.[114]

Additionally, as Donald Langevoort points out, there are situations where the Supreme Court seems to accept that liability outcomes will differ in SEC enforcements and private litigation.[115] He postulates that this is due to the extraordinarily high damages that can attach to the latter, which are often disproportionate to defendants' actual culpability.[116] It is not in the scope of this Article to address these ideas, beyond to emphasize that recognizing a moral dimension to securities fraud that hinges on scienter does not by any means exclude its presence in other elements.

B. Securities Fraud's Moral Dimension in Historical Context

The moral dimension of civil securities fraud is in line with the moral feeling surrounding the passage of the securities laws and their later significant amendments, as well as the Supreme Court case law that transformed Section 10(b) from a short vague provision into the litigation Mjolnir[117] we know today. Our current antifraud regime is not the inevitable product of the securities laws' historical context; the laws could have easily evolved in other ways with other enforcement priorities. Nor was the moral dimension a principal focus of the laws' drafters.[118] But the rhetoric of morality has played a pronounced if diffuse role in the passage and amendment of the securities laws. Examining this history through the gloss of moral judgment shows the role that morality has

113. 15 U.S.C. § 78u-2(a)(1)(A) (2012). The other main basis for civil penalties is a party's failure to heed a cease-and-desist order. *See id.* §§ 77t(d), 78u-2(a)(2). Punitive damages are also available in some cases of insider trading. *See* Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 351 & n.236 (2013).

114. *See* Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2128 (2010) [hereinafter Langevoort, *Reading* Stoneridge *Carefully*]. *But see* Winship, *supra* note 68, at 1118–19 (noting that the Fair Fund provision under Sarbanes-Oxley does not distinguish between penalty types for purposes of compensation).

115. Langevoort, *Reading* Stoneridge *Carefully*, *supra* note 114, at 2128.

116. *See id.*; *see also* Strudler & Orts, *supra* note 7, at 385 (focusing on causation, which is also not part of an SEC action).

117. Considered one of the most devastating weapons in existence, the hammer of Thor, Norse god of thunder, seems an eminently fitting metaphor for Section 10(b) today. *See* DAVID LEEMING, THE OXFORD COMPANION TO WORLD MYTHOLOGY 266–67 (2005).

118. *See generally* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 385, 414–24 (1990) [hereinafter Thel, *Original Conception*].

already played in shaping securities fraud jurisprudence, and will continue to play moving forward.

1. Statutory Origins

Securities legislation "has historically been the product of calamity."[119] Both the original securities acts, passed in 1933 and 1934, and their later significant amendments, have come in the wake of economic disasters. The Securities Act of 1933 and the Securities Exchange Act of 1934 were passed in response to the stock market crash of 1929.[120] What actually caused the crash, and whether the crash was the principal cause of the subsequent Great Depression, matters less than the fact that the public believed the two were intimately intertwined, and that unregulated speculation and Wall Street manipulators were to blame.[121] Church leaders dubbed the businessmen involved in the crash gamblers and hucksters,[122] suggesting that they had failed the nation not just economically, but morally as well. As America bid adieu to the prosperity of the roaring 20s, hemlines lengthened, outfits sobered, and the desire to upend the old moral regime dissipated in favor of exhibits of restraint and virtue.[123]

The main thrust of the new securities laws was full and accurate disclosure, reflected in the famous quotation of then-future Justice Louis Brandeis: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[124] The registration and disclosure requirements that form the bulk of the securities laws, as well as the creation of the SEC by the Securities Exchange Act, were all aimed primarily toward ensuring those involved in the

119. *Id.* at 407. Thel's words are particularly prescient as they predate the financial upheavals of 2000 and 2008, which, as he predicted, led to additional securities regulation. *See infra* notes 131–34 and accompanying text.

120. *Id.* at 408.

121. *See id*. at 408–09 & nn.97–98 (offering contemporaneous examples).

122. *See* Robert J. Shiller, *Listen Carefully for Hints of the Next Global Recession*, N.Y. TIMES (April 29, 2016), https://nyti.ms/1TjuTYO [https://perma.cc/28FA-7ZLH].

123. *Id.* Consumer spending in the United States plummeted in the year after the market crash. *See* Christina D. Romer, *The Nation in Depression*, 7 J. ECON. PERSPECTIVES 19, 29–31 (1993). The rate of spending declines was higher than in similarly situated countries, and contributed greatly to the depression's growing severity. *Id.* No doubt, the uncertain economic climate and individuals' losses were the principal causes of this trend, but the moral dimension counseling against demonstrations of excess and frivolity should not be ignored.

124. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (8th ed. 1932). Interestingly, despite the widespread use of this quotation, disclosure was not actually Brandeis's main focus in the book. He was much more concerned about the concentration of economic power and addressed his banking reform theories to that area. *See* Thel, *Original Conception*, *supra* note 118, at 406 n.90.

securities markets had full and accurate information at their disposal.[125] Private remedies existed as well, which allowed individuals to be compensated when they traded on material misrepresentations, but again, these were considered another way to encourage broad and accurate disclosures.[126] While there are plenty of references to the prevention of fraud as a broad statutory purpose,[127] there was little explication of how it was to be effected. The vagueness of the antifraud provisions was justified in part as a means to avoid offering a blueprint for fraudsters.[128]

The minutiae of regulation often stand in marked contrast with the sweeping rhetoric used to pass laws, and the securities laws were no exception. Both during his campaign and in public statements surrounding the laws' enactment, President Franklin Roosevelt made repeated references to the morally destructive nature of speculation as the reason for the securities laws, and promised a moral and ethical reform of Wall Street to restore investor confidence.[129] Members of Congress similarly made repeated references to the hucksters who caused the crash, the "widows and orphans" who were the hapless victims of securities fraud, and the need for new laws to protect them.[130]

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125. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) ("A fundamental purpose, common to [the early securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.").

126. *See, e.g.*, Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 680–81 (2014).

127. *See, e.g.*, SIXTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION 117 (1941), https://www.sec.gov/about/annual_report/1940.pdf [https://perma.cc/6KKG-D8TY] ("The Securities Act of 1933 is designed to compel full and fair disclosure to investors of material facts regarding securities publicly offered and sold in interstate commerce or through the mails. Its provisions are also designed to prevent fraud in the sale of securities.").

128. Both courts and the SEC have continued to be cautious about specifying what specific behavior constitutes securities fraud, offering as explanation the desire both to avoid providing a blueprint and also to prevent loopholing. *See* Langevoort, *SEC*, *supra* note 76, at 530–31; Kahan, *Ignorance of Law, supra* note 7, at 138–40. Some are skeptical of these purported reasons. *See, e.g.*, Langevoort, *SEC*, *supra* note 76, at 531 (pointing out "the dominance of lawyers in policymaking roles at the SEC" and arguing that one result is "an impenetrable admixture of highly technical securities law" only readable by experts). Regardless, this reality makes the development of a robust scienter requirement all the more important as a means by which to prevent overbreadth of application.

129. *See* Ronald J. Colombo, *Cooperation with Securities Fraud*, 61 ALA. L. REV. 61, 65 (2009); Thel, *Original Conception*, *supra* note 118, at 425–26, 425 nn.174–76. For a full article devoted to the moral purpose behind the securities laws' passage and early years, see John H. Walsh, *A Simple Code of Ethics: A History of the Moral Purpose Inspiring Federal Regulation of the Securities Industry*, 29 HOFSTRA L. REV. 1015 (2001).

130. *See* Sam Thypin-Bermeo, Comment, *The S.E.C. and the Damsel in Distress: A Contextual Analysis of the Duty of Best Execution*, 27 YALE J.L. & FEMINISM 169, 174–75 (2015) (collecting

The modern day economic scandals that led to significant amendments to the securities laws have similarly been discussed in moral terms; "[c]ommercial and financial crises are intimately bound up with transactions that overstep the confines of law and morality . . . ."[131] The Sarbanes-Oxley Act came in the wake of the accounting scandals of 2001 and 2002,[132] the Dodd-Frank Act in 2010 in response to the financial collapse of 2008.[133] The legislative history surrounding these amendments is replete with references to "the greed and recklessness of Wall Street," and the need to both keep such behavior in check and to punish it when particularly egregious.[134] It should come as no surprise then that both acts amended the securities laws to include more instances of both criminal and civil fraud liability, the latter focused particularly on reckless behavior.[135] These statutes also strengthened the SEC's and Department of Justice's (DOJ) enforcement powers, rather than those of private litigants, reflecting a longstanding legislative trend in securities law favoring government enforcement.[136]

The stated political motivation for legislative enactment is not generally used to interpret specific passages of the resulting law. However, as an expression of social norms imbued into a law, political motivation can be an invaluable indicator of underlying statutory purposes.[137] One big reason the securities laws came into existence, and likely why they successfully passed, was their stated goal of policing morally problematic behavior.[138] "[T]hey

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examples). Thypin-Bermeo also points out that in the years leading up to the crash, women had become an important investor population, though one viewed as incompetent, irrational, and easily preyed upon by dishonest brokers, which added a further moral dimension to the securities laws. *See id.* at 172–75.

131. CHARLES P. KINDLEBERGER, MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES 73 (4th ed. 2000).

132. *See* Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U. L.Q. 95, 96 & n.3 (2004).

133. *See* 155 CONG. REC. H14,760 (daily ed. December 11, 2009) (statement of Rep. Kilroy).

134. *See, e.g.*, *id.*; 107 CONG. REC. H4,692–93 (daily ed. July 16, 2002) (statement of Rep. Roukema); *see also* Ronald J. Colombo, Book Review, *Exposing the Myth of Homo Economicus*, 32 HARV. J.L. & PUB. POL'Y 737, 737–38 & nn.1–6 (2009) (collecting op-ed excerpts in wake of 2001–2002 scandals).

135. *See* Grundfest, *supra* note 113, at 350–51, 385 n.424.

136. *Id.* at 351; *see also* Khanna, *supra* note 132, at 103–17 (arguing that corporate crime legislation is particularly popular with lawmakers because corporate players prefer it to other types of regulation, and so offer less opposition).

137. *See* William N. Eskridge, Jr. & John Ferejohn, *Super-Statutes*, 50 DUKE L.J. 1215, 1270–75 (2001) (showing how statutes allow for the evolution of constitutional norms).

138. Ann Morales Olazábal, *Defining Recklessness: A Doctrinal Approach to Deterrence of Secondary Market Securities Fraud*, 2010 WIS. L. REV. 1415, 1417.

reflect a strong public desire for corporate accountability."[139] Beyond aspiring to prevent a repeat occurrence of such crises, the securities laws were passed in an environment keen to root out wrongdoing among corporate professionals. This purpose, then, may aid judges confronting close questions of legal interpretation, as Part IV details.

2. Judicial Interpretation of Section 10(b)

Section 10(b) of the Exchange Act, under which the bulk of securities fraud actions are brought today, is something of a statutory outlier. As we have already seen,[140] its text is minimal. Section 10(b) also had minimal legislative history surrounding it, due in part to the fact that it could not be rendered effective until the SEC promulgated a rule under it.[141] The SEC promulgated Rule 10b-5 in 1942, which was similarly sparse and passed with similar lack of fanfare.[142] When the SEC's commissioners were asked to approve the rule, it is said that the only comment made was one of them quipping, "Well . . . we are against fraud, aren't we?"[143] It is unlikely that any of them realized just how widely used the rule would be—and for what manner of behavior.[144]

Section 10(b) and the other antifraud provisions were clearly meant to complement what already appeared in the securities laws, but how they were meant to do so is the subject of significant debate.[145] What is not controversial is that Section 10(b) and Rule 10b-5 were intended to offer additional protection over what was already covered by common-law fraud.[146] This was due in part to the recognized remedial nature of the securities laws, particularly in those

139. *Id.* at 1448.

140. *See supra* Section III.A.1.

141. The generalized fraud provision in the Securities Act, Section 17(a), 15 U.S.C. § 77q(a) (2012), is much more rarely used and similarly barebones. *See supra* Section III.A.1.

142. Ray Garrett, Jr. & W. McNeil Kennedy, *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).

143. LOUIS LOSS ET AL., 2 FUNDAMENTALS OF SECURITIES REGULATION 1289 (6th ed. 2011) (quoting Garrett & Kennedy, *supra* note 142, at 922).

144. Steve Thel argues that the main purpose of Rule 10b-5 when it was passed was to prohibit securities fraud by purchasers, filling in a hole from Section 17(a) of the Securities Act, which only prohibited deceptive acts by sellers. *See* Thel, *Taking Section 10(b) Seriously*, *supra* note 15, at 27–28. This, according to him, is why no one expected that the rule would be particularly noteworthy. *Id.*

145. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983).

146. *Id.*; Edward A. Fallone, *Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach*, 1997 U. ILL. L. REV. 71, 133; Kevin R. Johnson, *Liability for Reckless Misrepresentations and Omissions Under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. CIN. L. REV. 667, 684 (1991).

causes of action brought by the SEC, which were litigated in the public interest. Furthermore, the section was designed to be flexible, reflective (at least in part) of the fact that fraud by its nature is constantly evolving.[147] Scholars also agree that there were multiple legal ancestors of Section 10(b), including not only common-law fraud, but also state blue sky laws and the federal mail fraud statute.[148] Scholars disagree regarding the significance of these sources for Section 10(b) interpretation.[149]

It is case law, particularly that of the Supreme Court, that took these statutory sources and purposes and transformed them into explicit causes of action.[150] Supreme Court cases began to make the scienter element of securities fraud more explicit in the 1970s and 80s, particularly in Section 10(b)'s implied private right of action. The Court has also repeatedly emphasized the significance of the common-law roots of securities fraud as justification for using common-law principles to aid in the interpretive task.[151] Those cases that treat scienter and clarify the contours of causes of action under the securities laws highlight the connection between securities fraud and traditional common-law fraud, and how common-law fraud—and its moral dimension—has played a role in justices' assessment.

The Supreme Court has not taken a consistent interpretive approach to deciding cases concerning the scope of Section 10(b).[152] Some scholars have accused the Court of recharacterizing its jurisprudence to render it more consistent than it actually is, as a method to justify shifting interpretive preferences and policy goals.[153] Whether or not this is an accurate assessment of the Court's actions and motives, what is true is that Section 10(b)'s

147. *See Huddleston*, 459 U.S. at 386–87.

148. Prentice, *supra* note 64, at 621–22. Blue sky laws are state laws that regulate the sale of securities, typically by requiring sellers of new issues to register their offerings and provide financial details. *Id.*

149. *See id.* All the progenitors of Section 10(b) had a moral dimension to them, and the mail fraud statute in particular was applied primarily with moral considerations in mind in the early years. *See id*. at 675.

150. *See* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005); Chiarella v. United States, 445 U.S. 222, 227–29 (1980).

151. *See, e.g.*, *Dura Pharm., Inc.*, 544 U.S. at 344; *Chiarella*, 445 U.S. at 227–30.

152. *See generally* David M. Phillips, *An Essay: The Competing Currents of Rule 10b-5 Jurisprudence*, 21 IND. L. REV. 625 (1988) (tracing different strands of 10(b) interpretative philosophy).

153. *See, e.g.*, Fallone, *supra* note 146, at 88–95 (focusing in particular on *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994)); *see also* Langevoort, *Rule 10b-5*, *supra* note 107 at S11–S15 (showing that Supreme Court jurisprudence in the 1960s through 80s was also affected by shifting public understandings of the purpose of securities regulation).

interpretation was quite fraught in Supreme Court case law of the 1970s, 80s, and 90s.[154]

That fraught history is due not only to justices' differing understandings of the purposes behind the securities laws (reflected in lengthy dissents in many key cases),[155] but also to the fact that the private right of action under Section 10(b), the focus of many of these cases, is implied, and not explicit.[156] The Supreme Court is now much less likely to infer private causes of action than it once was, and so the Court's Section 10(b) jurisprudence is further complicated by having to face the remnants of a practice no longer as acceptable.[157] Furthermore, because the Supreme Court did not first rule on the nature of Section 10(b) until 1971, it had almost three decades of lower court jurisprudence with which to contend; in many instances, that case law continues to be binding.[158]

The first reported decision that recognized a private right of action under Section 10(b) and Rule 10b-5 appeared in 1946.[159] In *Kardon v. National Gypsum Co.*, the district court relied on the Restatement of Torts and one previous Southern District of New York case to conclude that since the complaint before it clearly alleged a behavior that violated Section 10(b), and since Section 10(b) was clearly enacted (at least in part) to protect interests of individuals like the plaintiff, Section 10(b) must contain a private remedy for the plaintiff.[160] This holding was consistent with the general view in federal courts at this time that "every wrong shall have a remedy," and that this remedy should include a private right of action in addition to governmental enforcement authority.[161] The private right of action under Section 10(b) was adopted by an

154. Langevoort, *Fine Distinctions*, *supra* note 11, at 431–33.

155. *Id.* at 442 & n.47 (citing United States v. O'Hagan, 521 U.S. 642 (1997)).

156. *Id.* at 441 n.40.

157. *See Cent. Bank of Denver*, 511 U.S. at 195–96 (Stevens, J., dissenting); Langevoort, *Fine Distinctions*, *supra* note 11, at 436. The implied nature of the Section 10(b) private action also makes it more prone to accusations that its changes are the product of shifting policy goals and changes in interpretive methods. *Id.*

158. Steven Thel, *Section 12(2) of the Securities Act: Does Old Legislation Matter?* 63 FORDHAM L. REV. 1183, 1189 (1995) [hereinafter Thel, *Section 12(2)*].

159. Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513–14 (E.D. Pa. 1946).

160. *Id.* (citing Geismar v. Bond & Goodwin, Inc., 40 F. Supp. 876 (1941)); *see also* Herman & MacLean v. Huddleston, 459 U.S. 375, 380 & n.10 (1983) (recounting the history of the implied private right of action under 10(b)).

161. *See* Grundfest, *supra* note 113, at 322–24 (quoting Stoneridge Inv. Partners, L.L.C. v. Sci.-Atlanta, Inc., 552 U.S. 148, 176 (2008) (Stevens, J., dissenting)).

"overwhelming consensus of the District Courts and Courts of Appeals" before ultimately being endorsed by the Supreme Court in 1971.[162]

In 1975, the Supreme Court issued a decision in *Cort v. Ash* that made it much more difficult to read statutes as implying private rights of action.[163] While this holding did not render previously implied private actions moot, those actions were met with extreme skepticism moving forward.[164] In some instances, the Court began to narrow the dimensions of those private rights of action that "Congress did not authorize when it first enacted the statute and did not expand when it revisited the law."[165]

In Section 10(b)'s case, this happened quickly and dramatically. In the decade following *Cort v. Ash*, numerous Supreme Court opinions continued to refine the contours of Section 10(b), often choosing the narrower of potential interpretations.[166] These cases, and other cases interpreting the antifraud provisions in this period, are based on statutory language, despite the sparseness of that language where Section 10(b) is concerned. They focus deep attention on the "manipulative or deceptive device or contrivance" language of Section 10(b)[167] and whether or not similar language in other sections can be read as a corollary.[168]

These opinions reflect the justices' diverse understandings of the purposes of the fraud provisions and disagreement regarding how those purposes inform the interpretive task. The cases tend to include lengthy dissents highlighting

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162. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975); Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971).

163. *See* Cort v. Ash, 422 U.S. 66, 78 (1975). The Court established four factors that must be considered "[i]n determining whether a private remedy is implicit in a statute": (1) whether the plaintiff was intended to be benefitted specially from the statute; (2) whether the legislative intent offered any indication regarding a private right of action; (3) whether providing remedies for the plaintiff would be consistent with statutory purpose; and (4) whether the cause of action had been traditionally preempted by state law. *Id.*

164. *See* Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

165. *Id.* (quoting *Stoneridge*, 552 U.S. at 167).

166. *See, e.g.*, Santa Fe Indus. v. Green, 430 U.S. 462, 472–75 (1977) (holding that mere fiduciary breach was not actionable under Section 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that scienter was a requisite element of Section 10(b) suits); *Blue Chip Stamps*, 421 U.S. at 731, 754–55 (holding that private Section 10(b) suits can be brought only by actual purchasers or sellers of securities).

167. 15 U.S.C. § 78j(b) (2012).

168. *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 234–35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud."); *Santa Fe Indus.*, 430 U.S. at 473 ("The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception.").

such variance of opinion.[169] The cases follow a general trend in securities law decisions of the past fifty years; the justices split 5–4 "with an unusually great frequency," and with unusual and unstable distributions of the justices across that divide.[170] In other words, the history of Section 10(b)'s judicial interpretation is plagued by a lack of clear principals.

Some scholars have dedicated pronounced attention to arguing that Section 10(b) and Rule 10b-5 were meant to cover an expansive amount of actionable activity, and so the Supreme Court has gotten it wrong.[171] They use structural arguments, contemporaneous legislative and administrative materials, and early case law to make their points, with particular focus on advocating against further restriction of the Section 10(b) private cause of action.[172]

It is not in the scope of this Article to evaluate the merits of these arguments. What matters is that for the past half century, defining the scope of securities fraud has been the province of the courts. That is not likely to change, and whether or not one believes that the attendant body of law has a legitimate origin or consistent theory does not make it any less binding or real.[173] Supreme Court jurisprudence has repeatedly narrowed the scope of Section 10(b) to the point that today, "fraud under Rule 10b-5 means real deception, nothing less."[174] Whatever the motivation of the justices, the antifraud provisions have

169. *See, e.g.*, Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 198–99 (1994) (Stevens, J. dissenting) (criticizing the majority's holding that aider and abettor liability is not actionable under Section 10(b) with reference to the purpose of the section); Aaron v. SEC, 446 U.S. 680, 704–09 (1980) (Blackmun, J., concurring in part and dissenting in part) (using his understanding that the antifraud provisions "are key weapons in the statutory arsenal for securing market integrity and investor confidence" to argue against requiring scienter in actions brought by the SEC seeking equitable relief); *Blue Chip Stamps*, 421 U.S. at 761–62 (Blackmun, J., dissenting) (criticizing the majority for using the "blunt chisels" of legislative history and policy considerations to support its holding).

170. *See* Joseph A. Grundfest, *We Must Never Forget That it is an Inkblot We Are Expounding: Section 10(b) as Rorschach Test*, 29 LOY. L.A. L. REV. 41, 45–53 (1995).

171. *See, e.g.*, Fallone, *supra* note 146, at 77–79; Ramirez, *supra* note 126, at 687–700; Thel, *Original Conception*, *supra* note 118, at 461.

172. *See, e.g.*, Fallone, *supra* note 146, at 133 (arguing that Congress should codify securities fraud jurisprudence); Ramirez, *supra* note 126, at 672–73 (criticizing Supreme Court jurisprudence for limiting private securities litigation); Thel, *Original Conception*, *supra* note 118, at 461 (offering a detailed analysis of contemporaneous views of Section 10(b) and more modern understandings of the reason for its passage); Thel, *Taking Section 10(b) Seriously*, *supra* note 15, at 46 (making similar arguments in the context of SEC authority under Section 10(b)). *But see* Phillips, *supra* note 152, at 630 (arguing that even in early 10b-5 cases the Supreme Court focused "primarily upon the conduct of the defendants" and "the investing public generally" rather than the actual plaintiffs in a case).

173. *See* Thel, *Section 12(2)*, *supra* note 158, at 1192.

174. *See* Langevoort, *Fine Distinctions*, *supra* note 11, at 431 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473 (1977)).

been interpreted to closely align to traditional common-law fraud.[175] As a consequence, the antifraud provisions also mirror the common law's moral dimension.

Understanding civil securities fraud as morally charged is not the only way to read the history of Section 10(b)'s enactment and Rule 10b-5's later promulgation, but it also is not excluded by that history.[176] More importantly, Supreme Court opinions from the 1970s, 80s, and 90s, which emphasize a close textual reading of these and other sections of the securities laws requiring scienter, do align the laws more closely with the common-law roots of fraud by emphasizing the language of intent and deception.[177] Regardless of what happened historically, the moral dimension of fraud has been enshrined in the scienter requirement that now appears in multiple causes of action. Now that the moral dimension of fraud is established, it can and should be used to support a more principled and coherent jurisprudence moving forward.

IV. ADVANTAGES TO USING A MORAL LENS IN CIVIL SECURITIES FRAUD

The moral dimension of securities fraud, premised in the culpability of those found liable, is a social norm that plays a variety of roles in the securities laws' application. Understanding those roles and acting with them in mind will make for better law, be it through more principled application or as incentive for reform. The remainder of this Article devotes itself to showing how.[178]

Sections A, B, and C, focus on three rather particular issues in securities law related to scienter: heightened pleading requirements, greed as a motive to establish scienter, and recklessness as satisfying a scienter requirement. In each instance, recognizing the moral dimension of securities fraud can play a helpful role in legal analysis. Particular attention is paid to the recklessness question, as it is the one currently proving most troublesome to judges and most multidimensional. Sections D and E are more theoretical, devoting attention to how the moral dimension of civil securities fraud can inform jurisprudence,

175. *See Santa Fe Indus.*, 430 U.S. at 473; *see, e.g.*, *Dura Pharm., Inc.*, 544 U.S. at 344; Chiarella v. United States, 445 U.S. 222, 227–29 (1980).

176. *Cf.* Food and Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 143 (2000) ("At the time a statute is enacted, it may have a range of plausible meanings. Over time, however, subsequent acts can shape or focus those meanings.").

177. *Santa Fe Indus.*, 430 U.S. at 473; Langevoort, *Fine Distinctions*, *supra* note 11, at 431–32.

178. *Cf.* Dan M. Kahan, *Is Ignorance of Fact an Excuse Only for the Virtuous?*, 96 MICH. L. REV. 2123, 2127–28 (1998) ("Morally preachy law review articles can't really make society better; only political organizing can. One impediment to organizing, however, is that morally defective legal decisions frequently cloak themselves in mystifying abstractions . . . that deprive members of the public of a salient focal point for democratic deliberation.").

statutory amendment, and legal reform, as well as offer incentive to look outside litigation for ways to prevent fraud. All these Sections share a common thesis: that the moral dimension of civil securities fraud "provides a rational framework for judges, legislators, and administrators to deal with hard cases."[179]

A. Scienter's Role in Heightened Pleading Requirements

One area of movement in the securities laws, in which the moral dimension of fraud plays an explicit role, is the courts' tendency to apply the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) to factual fraud allegations in non-fraud sections of the securities laws. Courts' recognition of the moral dimension of securities fraud justifies their heightened inquiry when allegations of it appear.

Rule 9(b) concerns allegations of "fraud or mistake," and states that "the circumstances constituting fraud or mistake" must be "state[d] with particularity," while "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."[180] In non-class actions, Rule 9(b) remains the standard for securities fraud actions, though the PSLRA, which governs class actions, has a different standard that receives much more attention.[181]

Courts have generally held that allegations brought under the sections of the Securities Act that forbid material misrepresentations but require no showing of a mental state, such as Sections 11 and 12(a)(2), do not fall under Rule 9(b).[182] However, for a long time, confusion continued regarding what to do when claims "grounded in fraud"[183] are brought under these sections. If a Section 11 claim includes factual allegations of fraud: Should the heightened

179. *Cf.* Strudler & Orts, *supra* note 7, at 377 (making the same point in the insider trading context).

180. FED. R. CIV. P. 9(b).

181. The Private Securities Litigation Reform Act (PSLRA), requires pleading a "strong inference" of scienter in "securities fraud actions," a defined term in the statute and broader than the scienter-based definition this Article proposes. *See* Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737, 746–47 (1995); 15 U.S.C. §§ 78u-4(b)(1), (b)(2)(A) (2012). As mentioned, this definition has been interpreted to include Sections 11 and 12 of the Securities Act. *See supra* Section III.A.2. The interpretation of "strong inference" is one of the most contested issues in federal securities law. *See* Joseph A. Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 633 (2002).

182. *In re* NationsMart Corp. Secs. Litig., 130 F.3d 309, 315 (8th Cir. 1997).

183. *Id.*

pleading requirement apply because of the subject matter, or not, because of the action pleaded?[184]

Over the last fifteen years, circuits have generally adopted a standard first articulated by the Fifth Circuit:

> Where averments of fraud are made in a claim in which fraud is not an element, an inadequate averment of fraud does not mean that no claim has been stated. The proper route is to *disregard* averments of fraud not meeting Rule 9(b)'s standard and then ask whether a claim has been stated.[185]

In other words, when a plaintiff brings a non-fraud claim, but includes in support facts to establish the presence of fraud, those facts will still be assessed under Rule 9(b), and will be excised from consideration if they do not pass muster. Courts are indeed relying on the factual allegations of a claim, rather than the type of claim alleged, to determine the appropriate pleading standard.[186]

In explicating this rule, the courts of appeals express keen awareness that the moral judgment that attaches to "[f]raud allegations may damage a defendant's reputation regardless of the cause of action in which they appear."[187] One of the reasons fraud must be pleaded with particularity under Rule 9(b) is "to protect potential defendants from the harm that comes to their reputations when they are charged with the commission of acts involving moral turpitude."[188] Courts' recognition that accusations of fraud bring with them moral censure offers justification for these developments.

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184. *See id.* (collecting cases where courts have applied Rule 9(b) to Section 11 and 12 claims).

185. Lone Star Ladies Inv. Club v. Schlotzsky's Inc., 238 F.3d 363, 368 (5th Cir. 2001) (emphasis added). For cases all adopting the same standard, see Streambend Prop. II, L.L.C. v. Ivy Tower Minneapolis, L.L.C., 781 F.3d 1003, 1010–11 (8th Cir. 2015); Rombach v. Chang, 355 F.3d 164, 170–71 (2d Cir. 2004); and Vess v. Ciba-Geigy Corp. USA, 317 F.3d 1097, 1104–05 (9th Cir. 2003).

186. *Contra In re* Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 341 (S.D.N.Y. 2003) (refusing to apply Rule 9(b) pleading standards to Section 11 claims because "[w]hether Rule 8(a) or 9(b) is triggered turns on the type of claim alleged (*i.e.*, the cause of action) rather than the factual allegations on which that claim is based").

187. *Rombach*, 355 F.3d at 171 (quoting *Vess*, 317 F.3d at 1104).

188. Gross v. Diversified Mortg. Inv'rs, 431 F. Supp. 1080, 1087 (S.D.N.Y. 1977) (citing Segal v. Gordon, 467 F.2d 602, 607 (2d Cir. 1972)); *see also* U.S. *ex rel.* Joseph v. Cannon, 642 F.2d 1373, 1385 (D.C. Cir. 1981) (stating that Rule 9(b) "safeguards potential defendants from frivolous accusations of moral turpitude"). Interestingly, the text of the rule does not focus on mental element requirements. Instead, it states that only "the circumstances constituting fraud or mistake" must be "state[d] with particularity," while "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally." FED. R. CIV. P. 9(b).

B. Greed as Motive for Scienter Showing

The moral dimension of securities fraud is also valuable to consider when discussing the motive and opportunity test many courts accept as part of a successful scienter showing at the pleading stage. Again, the moral component offers justification for certain case law developments, but it also provides insight regarding how the test might be applied in cases moving forward.[189]

Under the motive and opportunity test, courts allow plaintiffs to allege facts evidencing the presence of a motive, in tandem with an opportunity to commit fraud, as evidence of scienter.[190] The motive and opportunity test developed out of Second Circuit jurisprudence and has become widely used,[191] though other circuits frequently emphasize that motive analysis is only *relevant* to a scienter inquiry, rather than dispositive.

Plaintiffs alleging securities fraud often attempt to use evidence of greed to establish motive under the test, and there is frequent disagreement regarding what type of greed should satisfy the motive. Some posited evidence of greed, such as an officer's desire to retain his or her highly compensated job, earn a bonus, or keep a company profitable, is generally rejected by courts because it is the type of action required to be successful in business.[192] It would be illogical to see such motivations as suggestive of foul play given that they are ubiquitous, and admired, in the industry at large.[193]

Understanding scienter to imply moral wrongdoing does two things here. First, it offers clearer validation to use greed as evidence of motive in a scienter inquiry. Not only is greed widely recognized as immoral in Western thought and American jurisprudence,[194] but it has also formed one of the principal

189. *See supra* Section IV.A.

190. *See* Hillary A. Sale, *Judging Heuristics*, 35 U.C. DAVIS L. REV. 903, 918–19 (2002).

191. *Id.* (tracing the origins of the test to the mid-1980s); Ann Morales Olazábal & Patricia Sanchez Abril, *The Ubiquity of Greed: A Contextual Model for Analysis of Scienter*, 60 FLA. L. REV. 401, 410–12 (2008) [hereinafter Olazábal & Abril, *Greed*] (showing circuits' differing consideration of the motive and opportunity test in the context of the PSLRA); Ann Morales Olazábal, *The Search for "Middle Ground": Towards a Harmonized Interpretation of the Private Securities Litigation Reform Act's New Pleading Standard*, 6 STAN. J.L. BUS. & FIN. 153, 169–71 (2001) (summarizing the state of the law after passage of the PSLRA).

192. *See* Samuel W. Buell, *Culpability and Modern Crime*, 103 GEO. L.J. 547, 552–53 (2015) [hereinafter Buell, *Culpability*]. It is more or less required at this point to quote Gordon Gekko: "The point is, ladies and gentlemen, that greed—for lack of a better word—is good. . . . Greed, in all of its forms . . . has marked the upward surge of mankind. And greed . . . will not only save [this company], but that other malfunctioning corporation called the U.S.A." WALL STREET (20th Century Fox 1987).

193. *See, e.g.*, Acito v. IMCERA Grp., Inc., 47 F.3d 47, 54 (2d Cir. 1995) (holding that allegations of officers' motive to increase their pay was insufficient to establish scienter).

194. *See* Olazábal & Abril, *Greed*, *supra* note 191, at 403 (collecting examples).

justifications for the securities laws in particular.[195] Public perceptions of the financial collapses that presaged the securities laws and emendations often viewed greed as a cause, and so, as elucidated above,[196] the need for an accounting of the greedy was written into the DNA of the laws that were passed.[197] The legislative history surrounding Sarbanes-Oxley and Dodd-Frank in particular makes numerous references to greed, often tying it to reckless behavior to paint a picture of a grossly irresponsible corporate industry that dragged the country into ruin in pursuit of a bottom line: "The greed and recklessness of Wall Street has cost Main Street dearly."[198]

Second, the moral dimension of fraud offers guidance on how to parse truly blameworthy greedy behavior from non-actionable motives, culpable conduct from that "adhering to what is essentially accepted as the social norm of [the defendants'] immediate peer group."[199] White collar crime often brings with it "moral complexity and uncertainty" because of the blurring of boundaries between wrongful and praiseworthy behavior in the commercial realm.[200] What counts as acceptable aggressive dealing, as opposed to criminal fraud, is not always obvious or amenable to bright line-drawing.[201] This dilemma extends to civil corollaries of such laws as well.

Ann Morales Olazábal and Patricia Sanchez Abril have performed a close examination of how greed is used as motive evidence for scienter in the securities class action context, and have constructed a model for analyzing such

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195. *See* Langevoort, *Fine Distinctions*, *supra* note 11, at 434 (arguing that a central premise used to justify insider trading regulation was that greed threatened market integrity).

196. *See supra* text accompanying notes 132–34.

197. John Coffee succinctly labeled the 2008 financial collapse "a simple story of greed, rationalization, and sloth." John C. Coffee, Jr., *What Went Wrong? A Tragedy in Three Acts*, 6 U. ST. THOMAS L.J. 403, 403 (2009) [hereinafter Coffee, *What Went Wrong?*].

198. 155 CONG. REC. H14,760 (daily ed. Dec. 11, 2009) (statement of Rep. Kilroy); *accord* 155 CONG. REC. E2,943 (daily ed. Dec. 9, 2009) (statement of Rep. Fattah) ("Many homeowners now find they are unable to meet their financial obligations due to the severe recession caused by the unbridled greed and recklessness of many financial services institutions."); 107 CONG. REC. S6,528 (daily ed. July 10, 2002) (statement by Sen. McCain) ("We must make some fundamental changes in the current system of corporate oversight to protect Americans from avarice, greed, ignorance and criminal behavior."); 107 CONG. REC. S7,426 (daily ed. July 26, 2002) (statement by Sen. Biden) ("To restore some level of confidence, the accounting reform legislation we have passed is critical to stem the corporate greed threatening our economy.").

199. *See* Jed S. Rakoff, *Conjoining "Recklessness" in Securities Fraud Cases to Moral Culpability*, 44 LOY. U. CHI. L.J. 1447, 1453 (2013); *see also* Green, *Moral Ambiguity*, *supra* note 13, at 506 ("Many instances of alleged extortion, fraud, and similar offenses are difficult to distinguish from conduct that involves 'merely aggressive' business, litigation, or political behavior.").

200. Green, *Moral Ambiguity*, *supra* note 13, at 502.

201. *See* Buell, *Culpability*, *supra* note 192, at 559.

evidence with reference to the magnitude, timing, and atypicality of the conduct at issue.[202] For example, a complaint showing that a defendant's stock trades were both unusually large compared to both characteristic sales in the company as well as to the defendant's own trading history will likely fare better in arguing a motive for scienter.[203]

Olazábal and Sanchez's rubric is an excellent tool, but allowing a judge to consider evidentiary issues with reference to morality can offer a helpful additional lens. Judges considering specific examples of greed can use the question of how blameworthy the behavior is in the context of the industry to distinguish ordinary human desires and business requirements from unusual attitudes that can point to something potentially actionable at stake.[204]

C. Recklessness as Scienter in Civil Securities Fraud

One of the most multidimensional ways in which recognizing the moral dimension of civil securities fraud can serve as a useful interpretive tool involves the place of recklessness in securities fraud. While it is no longer controversial that recklessness can satisfy securities fraud's scienter showing, questions such as what behavior qualifies as reckless, how recklessness must be pleaded, and what evidence can be used to prove recklessness, remain sources of confusion.[205]

Understanding securities fraud as morally charged not only offers judges guidance with regard to certain findings connected to recklessness, but also links evidentiary conclusions to the constitutive law, giving judges more confidence that their rulings fit into the broader purposes behind the securities laws' fraud provisions. The result is a way to steer the law surrounding recklessness in a more coherent and principled direction while still functioning within the confines of existing precedent, even between circuits.

1. The Recklessness Problem

In order to understand the usefulness that the moral dimension of securities fraud can offer to the challenges raised by recklessness assessments, it is important, first, to understand the nature of those challenges. While scienter

202. *See* Olazábal & Abril, *Greed*, *supra* note 191, at 415–20.

203. *Id.* at 413–15.

204. See the following Section C for a more detailed explanation for how this lens can be used in recklessness assessments.

205. *See infra* Sections IV.C.1.a, IV.C.2.a–b.

has been an established element of securities fraud for four decades,[206] it has been less clear what that mental element encompasses. Scienter is defined as "[a] mental state consisting in an intent to deceive, manipulate, or defraud."[207] However, the contours of that definition are in dispute, chiefly regarding how recklessness fits into the definition. In 1976, a Supreme Court footnote raised the possibility that recklessness might satisfy the scienter requirement in Section 10(b) actions as "a form of intentional conduct," but the Court declined to rule on the issue.[208] Since then, every court of appeals to address the issue has decided that recklessness does indeed satisfy the scienter requirement for 10(b) actions.[209] Given the strong effect that Section 10(b) case law exerts on other securities law jurisprudence, it would be safe to say that a similar understanding of scienter would inform wherever else it appears in the securities laws.

a. A Missing Definition and Jurisprudential Inconsistency

Unfortunately, what constitutes recklessness for purposes of securities fraud is still notoriously difficult to say.[210] In part, recklessness assessments face the same problem that all scienter assessments do: the definition of scienter itself is a porous one, and the law's state-of-mind rules can prove a poor corollary to how social scientists conceive of similar entities.[211] In other words, the steps that a judge must take under the law to make a proper scienter assessment often bear little resemblance to how intent to deceive actually operates. It certainly does not help matters that the meaning of recklessness in non-legal contexts bears little to no resemblance to intentionality.[212]

Additional ambiguity arises from the variable definition of recklessness itself within the law. Recklessness operates on a spectrum in our law. Sometimes it is best characterized as a "negligence plus" standard, and sometimes it is just a hair shy of actual intent to injure.[213] Sometimes it is

206. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976) (requiring scienter in private Section 10(b) actions); Aaron v. SEC, 446 U.S. 680, 691, 697 (1980) (requiring scienter in SEC-brought Section 10(b) actions and for claims brought under Section 17(a)(1) of the Securities Act).

207. *Scienter*, BLACK'S LAW DICTIONARY (10th ed. 2014).

208. *See Hochfelder*, 425 U.S. at 193 n.12.

209. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007); *see e.g.*, Ottmann v. Hanger Orthopedic Grp., Inc., 353 F.3d 338, 343 (4th Cir. 2003).

210. *See* Grundfest & Pritchard, *supra* note 181, at 651.

211. *See* Langevoort, *Martha Stewart*, *supra* note 66, at 2–3.

212. *See, e.g.*, *Reckless*, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2003) ("marked by lack of proper caution : careless of consequences").

213. *See* Johnson, *supra* note 146, at 687–95.

assessed objectively, based on what a reasonable person should have known under the circumstances, and sometimes it is subjective, requiring proof of what the defendant actually did know and nonetheless chose to ignore or acted in spite of.[214] The Supreme Court has conceded in other contexts that recklessness is a concept that "cannot be fully encompassed in one infallible definition";[215] it would seem that problem surfaces in securities fraud as well.

There has been a great deal of scholarship devoted to various problems that the specter of recklessness raises in securities fraud.[216] Donald Langevoort and Ann Olazábal, among others, have reviewed recent case law and demonstrated a complete lack of coherent standards, including within individual circuits, for how to make a recklessness determination in Section 10(b) cases.[217] Circuits, wary of diluting the intent standard, are clearly uncomfortable with the lower forms of recklessness constituting scienter, and so they will refer to the standard as conscious recklessness, deliberate recklessness, severe recklessness, extreme recklessness, and similar phrasings, and sometimes will even offer a specific description or definition.[218] But confusion persists.[219]

When it comes to deciding whether a particular complaint has pleaded fraud with specificity, or if the evidence can show liability, there is little practical consistency.[220] Judges (and juries) struggle with how to apply the definitions, vague or specific, to the case before them.[221] No doubt, the fact that the vast majority of recklessness assessments happen at the pleading stage adds to the challenge.[222] Only minimal facts are available at this point, leaving the inquiry necessarily in a more theoretical realm.

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214. *See* Kuehnle*, supra* note 64, at 161. Kuehnle explains that the objective form of recklessness finds its source in tort law. *See id*. at 181–84.

215. St. Amant v. Thompson, 390 U.S. 727, 730 (1968); *see also* Farmer v. Brennan, 511 U.S. 825, 836 n.4 (1994) (calling the concept of recklessness "nebulous").

216. *See, e.g.*, Johnson, *supra* note 146; Kuehnle*, supra* note 64; Ann M. Olazábal & Patricia S. Abril, *Recklessness as a State of Mind in 10(b) Cases: The Civil-Criminal Dialectic*, 18 N.Y.U. J. LEGIS. & PUB. POL'Y 305, 307 (2015) [hereinafter Olazábal & Abril, *Recklessness*].

217. *See, e.g.*, Langevoort, *Fine Distinctions*, *supra* note 11, at 435–41; Olazábal, *supra* note 138, at 1424–29; *see also* Kuehnle*, supra* note 64, at 179–81 (tracing some of the confusion back to the 1977 Seventh Circuit case, *Sundstrand v. Sun Chem. Corp.*, 553 F.2d 1033 (7th Cir. 1977)).

218. Olazábal, *supra* note 138, at 1424–29.

219. *See* Olazábal & Abril, *Recklessness*, *supra* note 216, at 320–24.

220. *See id.* at 320–25.

221. *See id.*

222. The vast majority of securities fraud actions settle before summary judgment. *See* Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review*, NERA 21–27 (2017), https://www.supremecourt.gov/opinions/URLs_Cited/OT2016/16-373/16-373-1.pdf [https://perma.cc/QB78-8D6E].

b. Lower Standards for Criminal Conviction

Perhaps even more troubling, if one takes a step back and considers that recklessness can also satisfy the mental element for criminal securities fraud liability, it appears that the threshold for evidence leading to criminal conviction is sometimes lower than that for civil. Criminal cases that favor "circumstantial, objective-style assessments" over requirements of subjective knowledge showings can lead to convictions based on allegations that never would have passed muster at the pleading stage in a civil case in the same court.[223]

2. Morality as an Offer of Guidance and Clarification

Conceiving of securities fraud as a morally wrongful act confers a number of advantages to judges interpreting and applying the securities laws in instances where recklessness is at issue, and even, potentially, the lawyers involved. It offers a basic yardstick for preliminary recklessness assessments. It also provides justification for requiring a higher showing for recklessness, which is in line with Section 10(b)'s origins and evolution, and may raise the quality and success of securities fraud suits brought while funneling other meritorious cases to more appropriate sections of the securities laws. People bring lawsuits for myriad reasons; if securities fraud is positioned to pursue the morally blameworthy, other causes of action may become simpler paths for pursuing compensation.

a. Morality as a Judicial Tool in Recklessness Assessments

The broadest advantage that the moral dimension of civil securities fraud provides is that it offers a lens by which to assess whether pleadings or evidence satisfy the recklessness standard. If the pleading or evidence evinces morally blameworthy behavior—a defendant not only not knowing and not caring about the truthfulness of the statement made, but doing so in a way clearly at odds with surrounding social norms—a judge can take some comfort in beginning from the premise that recklessness exists.[224] In other words, moral blameworthiness can act as an interpretative tool for judges deciding whether behavior satisfies the recklessness standard.

Judge Jed Rakoff has made a similar argument in the criminal context, explaining that recklessness, confusing in the abstract, can be "a useful

223. Olazábal & Abril, *Recklessness*, *supra* note 216, at 329.

224. *Cf.* Kuehnle, *supra* note 64, at 170–71 (contrasting heightened negligence recklessness and fraud recklessness historically, and identifying the latter as "reflect[ing] a moral deficiency").

concept" if "tied to its moorings . . . in moral culpability."[225] He asserts that despite the special problems the question of intent can raise in securities fraud, overall, "judges and juries have little difficulty in determining intent in most cases."[226] The exception, he says, is recklessness, whose definition, even if comprehensible, is often "a little too vague, a little too manipulable" to encompass behavior it should not.[227] The dividing line, rather, is moral culpability.[228] Individuals who may act somewhat recklessly, but in doing so "adher[e] to what is essentially accepted as the social norm of their immediate peer group," are not deemed culpable.[229] Rather, only an individual who consciously disregards what her peers would immediately identify as inappropriately risky is morally culpable and, by extension, liable. Without this last step, "you deprive the action of its moral justification."[230]

Judge Rakoff's points are equally applicable in the civil context. Regardless of the specific standard a judge uses to assess recklessness within a scienter showing, she can use the question of moral culpability to assess whether that standard has been met.[231]

An example on this point may prove helpful. Let us examine a hypothetical, which I borrow wholesale from a work by Ann M. Olazábal and Patricia S. Abril:

> [Imagine a case where a] corporation issues an earnings report containing various misrepresentations regarding the strength of its soon-to-be-released—and financially critical—product line. In an open analyst call, the CEO suggests that the product launch was delayed because, in her experience, the fall buying season offers a more favorable marketplace. In reality, the launch had been delayed because the flagship product of the line malfunctions frequently and tests poorly. Evidence reveals that it is "common knowledge" among the company rank-and-file that the new product being touted as the savior for the failing firm is in fact a dud. The fact is that the product is destined to fail, and the company has no other promising

225. *See* Rakoff, *supra* note 199, at 1456.

226. *Id*. at 1449.

227. *Id*. at 1450–53. Judge Rakoff offers the example of speeding on a highway when every other car is doing the same thing. *Id.* at 1451–53.

228. *Id.* at 1455–56.

229. *Id*. at 1453.

230. *Id*. at 1456.

231. Samuel Buell similarly muses upon ways to use intuitions of wrongfulness to help decide close cases in modern crimes like fraud, and extortion. *See* Buell, *Culpability*, *supra* note 192, at 600–02.

> products in its pipeline. In the short term, the CEO's misdirection artificially props up the stock price; but when the truth comes out, the stock plummets. Injured shareholders file a civil suit [under section 10(b)].[232]

Olazábal and Abril's hypothetical concludes with the judge dismissing the suit and being upheld on appeal because there is no "smoking gun of a memo to the CEO detailing the product's malfunctions."[233]

The complaint alleges that it was common knowledge at the company that the professed hit product is in fact a flop, and the suit was dismissed because of the failure of the complaint to tie that knowledge to the person making the statement.[234] But the lack of a smoking gun does not make dismissal a foregone conclusion. Rather, it leads to questions such as: What sorts of facts could a complaint plead in this situation to survive dismissal? And what sorts of findings could a judge make?

Let us assume that the CEO cannot be shown to have actual knowledge that the product was a flop, and so we are in recklessness territory. The key question, then, is: What degree of unawareness could the CEO have of this reality when making her statement that crosses the line between acceptable and actionable? The answer to that question will rest on many factors, including:

1. What information was accessible to the CEO regarding the product at issue?
    a. How was that information compiled and checked for accuracy?
    b. What level of expectation was there for her to review that information, and how often?
    c. Did she in fact review the information in an appropriate manner?
    d. Did that information raise any red flags as to the soundness of the product at issue such that she should be expected to investigate further?
2. How was the CEO was prepared for the call?
    a. What information was compiled for her, and how was that information checked?
    b. In preparing for the call, were any red flags raised prompting a need for further investigation or follow-up?
    c. Was there any reason for follow-up after the call and the statement at issue?

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232. *See* Olazábal & Abril, *Recklessness, supra* note 216, at 305–06 (footnote omitted).

233. *Id*. at 306.

234. *Id.* at 305–06.

3. What was the CEO's level of contact with the company rank and file?
    a. Was this contact such that the truth should have come out, given her interactions?
    b. Was there any evidence that the CEO deliberately shielded herself from learning the truth in some way, an example of "willful blindness" actionable under the securities laws?

The inquiry, suffice to say, is vast, and particularly difficult to assess at the motion to dismiss stage, since no discovery has happened yet. Recognizing the moral dimension of recklessness does not offer an easy solution, but rather can guide a judge's assessment. In examining each of these questions, the judge can bear in mind that she is looking for indications of behavior that crosses the line from acceptable corporate conduct to blameworthy behavior. Reckless behavior on the part of the CEO will be that which sets her apart from her peer group. A judge who keeps this simple point in mind can analyze the complaint and attendant filings with a centralizing point of inquiry.

I am deliberately not offering a precise recklessness standard for judges to adopt here. A myriad of other scholars have articulated such standards already. If these standards have been helpful to judges and litigants, then I have little more to contribute. If these standards are not helpful, I suspect there are two main reasons: the often vague nature of such standards, as explicated in Part II, or the difficulty courts face in aligning a scholar-devised standard with their circuits' own case law.

Keeping the general idea of the morally blameworthy in mind when making pleading and evidentiary calls may well prove more helpful than attempting to apply a more precisely articulated standard. It is more intuitive for a judge to consider that she is looking for a culpable state of mind than whatever precise (or not so precise) standard is being used in her district. Using morality as an interpretive lens in the recklessness inquiry also recognizes the practicalities of judging; judges often use such tools to analyze and analogize how to apply complicated doctrine to specific facts.[235]

This approach is not only helpful to judges, but good for consistency's sake. Judges are bound by the precedent in their respective circuits when making recklessness assessments, but the moral lens both aligns with these precedents and offers a way to standardize them. Judges will not be pressured to conflict with whatever standards already govern particular circuits, while

235. *See generally* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, *in* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 3 (Daniel Kahneman et al. eds., 1982); Chris Guthrie et al., *Blinking on the Bench: How Judges Decide Cases*, 93 CORNELL L. REV. 1 (2007); Sale, *supra* note 190.

simultaneously being able to move closer to clarity and consensus by reference to the moral lens. Judges thus can make their rulings with more confidence that they are based on the underpinnings of the cause of action at issue and that their colleagues are following suit.

Of course, many of the same scholars who discuss judges' use of heuristics, or mental shortcuts, also point out the primary disadvantage of the practice: it can lead to systemic errors and biases.[236] In the securities context, for instance, there is concern that busy judges encountering complex cases may gravitate toward heuristics that make it easier to dismiss them. Indeed, some scholars allege that it is precisely the use of "instinctual reactions" that has led to the current state of disarray.[237]

I am sympathetic to these arguments and sensitive to these criticisms. However, using morality as an interpretive lens is not the same thing as implementing a heuristic. As demonstrated through the earlier hypothetical analysis, it is simply another way to engage in lengthy deliberative decision making, albeit with a concentrated focus.[238] At its most heuristic-like, this interpretive lens is only a first step, not a substitution for reasoned judgment.[239] Furthermore, the riskiest types of heuristics are those that are unconscious and based on faulty assumptions. The risk of bias and error in heuristics is minimized when judges are aware of the tools they are using and when these tools have a sound basis.[240] That is the case here. Judges will still need to make use of the standards of law and content of the complaint or evidence to show that the presence or absence of scienter rises above mere intuition.

b. A Higher Recklessness Showing Requirement

The moral dimension of civil securities fraud also serves as confirmation of and justification for requiring a higher showing of recklessness—one approaching intentionality—for liability to attach. The mental element of

236. *See, e.g.*, Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83 (2002); Guthrie, *supra* note 235, at 29–33; Sale, *supra* note 190, at 906–14. *But see* Donald C. Langevoort, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?*, 51 EMORY L.J. 309 (2002) (reviewing Bainbridge and Gulati's article and offering some criticisms).

237. Olazábal, *supra* note 138, at 1442; *see also* Sale, *supra* note 190, at 909–10.

238. To use Daniel Kahneman and Amos Tversky's vocabulary, this is a tool to focus on System 2 (deliberative) thinking, rather than a System 1 (automatic thinking) replacement. *See* DANIEL KAHNEMAN, THINKING, FAST AND SLOW 20–30 (2011).

239. *Cf.* Guthrie, *supra* note 235, at 33 (offering an example of how intuition can guide deliberative thought).

240. *See id.* at 38–40.

securities fraud takes guidance from that in traditional common-law fraud, which, as delineated above, encompasses acts of deception that impute bad faith to the actor.[241] If, then, those found liable for civil securities fraud will be labeled as deviators from accepted social norms, it makes sense to require a high showing for this label to attach.

This higher showing has several beneficial implications. First, it makes securities law more consistent with the trend of Supreme Court case law on the subject. Second, it offers better justification for enforcing the securities laws, and possibly greater chance for success. Third and finally, a higher recklessness showing can act as an effective check against unprincipled overexpansion of the securities fraud regime.

First, and most simply, recognizing a stricter recklessness requirement puts the law in line with the past four decades of Supreme Court jurisprudence, which has moved toward a more restrictive reading of securities fraud liability.[242] While some criticize these decisions, all acknowledge their precedential status, and we should recognize their implication. Lower court judges applying the securities laws can do so with raised confidence that they are following the path dictated by national precedent.

Second, a higher recklessness showing encourages using securities fraud to go after the morally blameworthy. This puts securities fraud in line with the rhetoric that lawmakers used to pass it, which strengthens the rationale for expending governmental resources on such cases. Even more importantly, pursuing the morally blameworthy may lead to a better investigative process and more satisfying results. Securities fraud investigations and lawsuits are often very long, involve hundreds of filings, and result in settlements that contain no acknowledgment of culpability. Many have expressed frustration with how little clarity settlements in particular offer regarding who is culpable.[243] Premising liability on culpability makes it more likely that administrative or judicial proceedings will undertake the sort of inquiry into wrongdoing that can countermand these tendencies, offering at least part of the reckoning called for by so many.[244]

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241. *See supra* Section II.B.

242. *See* Fallone, *supra* note 146, at 112–13.

243. *See, e.g.*, Jason E. Siegel, Note, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 GEO. L.J. 433, 455–64 (2015); James B. Stewart, *S.E.C. Has a Message for Firms Not Used to Admitting Guilt*, N.Y. TIMES (June 21, 2013), https://nyti.ms/10DRJoU [https://perma.cc/47A8-PLLZ].

244. As explained later, a higher showing for civil securities fraud also has helpful implications when considering criminal suits. *See infra* Section IV.D.

Similarly, by making it harder for securities fraud liability to attach, a higher showing of recklessness can raise the percentage of successful securities fraud actions brought. This may seem counterintuitive, but if a higher requirement is recognized, it might convince those bringing actions to limit themselves to those cases more likely to succeed. This would be particularly advantageous in instances where the government is bringing suit. Dan Kahan has pointed out that a major issue of low-certainty prosecution, even with high-severity punishment for those convicted, "is that it is more likely to signal to potential law-breakers that like-situated persons are engaged in crime."[245] If lots of people are accused of securities fraud but never punished, the message sent to potential violators is that the practice is so rampant that it is both statistically safe to engage in and bereft of reputational costs. Having fewer suits, and having those suits not be decided on popularly perceived technicalities like nuances of phrasing, would go a long way toward addressing this message, as well as the crisis of confidence in the securities laws' efficacy.

The incentives at play in the private sector are obviously somewhat different. Private lawsuits are brought for various reasons, including earning vindication for a perceived wrong, convincing a defendant to change their policies or behavior, and seeking to develop the law in a new direction. Many private lawsuits have compensation as their primary objective, and in these situations, so long as plaintiffs believe they are more likely than not to survive a motion to dismiss, they probably will continue filing securities fraud cases in hopes of generous settlements.

If, however, courts reach a point where they are particularly demanding for securities fraud cases, it may serve as incentive for private plaintiffs to begin to avail themselves of other actions under the securities laws available to challenge misrepresentations and omissions, on the reasoning that these would offer better chances of success and a simpler means of achieving it. One reason plaintiffs flock to Section 10(b) is that there is robust case law surrounding it, which provides helpful guidance on how to structure adequate pleadings.[246] But lawyers seek efficiency, and for some cases the advantage of the known might well be offset by the simplicity of filing under a cause of action that did not require a scienter pleading. If there is even small movement in this direction, the dominating role of Section 10(b) will diminish somewhat, paving a path for

245. *See* Kahan, *Social Influence*, *supra* note 19, at 378.

246. *See, e.g.*, Jay B. Kasner & Mollie M. Kornreich, *Section 10(b) Litigation: The Current Landscape*, ABA (Oct. 2014), https://www.americanbar.org/publications/blt/2014/10/03_kasner.html [https://perma.cc/RA27-CV4G] (summarizing recent case law for each element of Section 10(b) claims, much of which came from the pleading stage).

distinction and beneficial definition of other causes of action.[247] And in the long run, lawsuits that require proof of fewer elements can be processed more quickly, easing the burden on the judiciary.

No doubt many readers are loudly protesting that securities fraud is already notoriously hard to prove—Why would we want to make it even harder? I emphasize, then, that if securities fraud is a pronouncement of moral blameworthiness—and it is—then it *should* be hard to prove. The law reflects societal norms that target and condemn blameworthy behavior; we should be very sure that the individuals we are painting with such a brush deserve it.[248]

The third benefit of a higher showing of recklessness is that it ensures that civil liability does not go too far. Requiring proof of moral culpability prevents a witch hunt, where those who have been harmed by financial institutions look for someone to blame without due regard to whether the defendant has in fact acted wrongly. Vague provisions of intent requirements risk determinations of liability and censure without sufficient due process. This is particularly likely in fraud actions; since they are already flexible regarding the type of conduct they encompass, the requisite mental element has to act as the barrier.[249]

Conceiving of civil securities fraud as morally blameworthy gives courts a tool to ensure individuals are shielded from those out for blood at any cost. In doing this, it plays a role similar to the mens rea requirement in criminal law.[250] Obviously, some culpable individuals will slip through the cracks; any mental element will always be under-inclusive, because it is never perfectly discoverable.[251] But given the penalties at stake, that is likely better than the alternative.

D. Distinction for Judicial Definition, and a Path for Congressional Emendation

Conceiving of securities fraud as morally blameworthy also clarifies its distinct place within the wider securities legal landscape, for purposes of analogizing between different sections of the law, addressing risks of overcriminalization, and paving the way for more principled statutory emendation if and when that time comes.

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247. We have already seen the stirrings of such movement. Class actions alleging violations of Section 11 of the Securities Act, which does not require scienter, more than doubled between 2013 and 2015, though they declined in 2016. *See* Boettrich & Starykh, *supra* note 222, at 8.

248. This reality also offers a partial response to the disparity between criminal and civil liability in the securities laws, which will be discussed in the next Section. *See infra* Section IV.D.

249. *See supra* notes 61–63, 107.

250. *See* Buell, *Culpability*, *supra* note 192, at 586; *see also supra* Section II.A.2.

251. *See* Buell, *Novel Criminal Fraud*, *supra* note 16, at 2021.

As explained earlier, much of the Supreme Court's securities fraud case law is premised on historical reconstruction: using textual analysis to search for the provision in the securities laws most analogous to whatever section is in need of elucidation.[252] Often, the Court will consider the element in the analogous provision as the outside boundary, particularly when elucidating private rights of action. The Court has stated that the practice promotes clarity, consistency, coherence, and legislative purpose.[253]

This practice of analogizing continues in courts of appeals today.[254] It can be an effective exercise, but there is always the risk that an unsuitable section will be used, a risk exacerbated when some factual scenarios or sections of the securities laws are casually classified as fraud without recognition of the potential consequences. In particular, using more robust fraud sections of the securities laws to inform the contours of other sections where negligence or "weak" recklessness are the requisite states of mind may well exclude certain potential parties for no principled reason.

Reinforcing that securities fraud is morally charged emphasizes that only those provisions with a strong mental element should be considered fraud, and that the presence of scienter offers strong justification to analogize between different provisions with that element. It also distinguishes the misrepresentation provisions of the laws as a separate group with separate purposes, allowing for a more robust and consistent body of law to develop in each corner. Samuel Buell has called SEC Rule 10b-5 "a legal Swiss army knife—used to punish, to enjoin, to shame, to regulate, to fine, to debar, to sue, to compensate, and more."[255] And thus far, "Congress has acquiesced in the experiment of allowing federal courts to develop a federal common law of securities fraud."[256] If securities fraud is morally charged and perpetrator-focused—used for censure, punishment, and deterrence—then pronouncing its distinction from the securities laws in general makes it simpler for non-fraud cases to focus on other purposes, like ensuring full and accurate disclosures. If underutilized sections of the securities laws are identified, they can be developed into more effective tools for a variety of purposes. And, as explained

252. *See supra* Section III.B.2.

253. *See* Musick, Peeler & Garrett v. Emp'rs Ins. of Wausau, 508 U.S. 286, 295 (1993); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 360–61 (1991); Grundfest, *supra* note 113, at 312.

254. *See, e.g.*, Dekalb Cty. Pension Fund v. Transocean Ltd., 817 F.3d 393, 405–07 (2d Cir. 2016) (examining which sections of the Securities and Exchange Acts a certain section most closely resembles in determining whether a statute of repose applies).

255. Buell, *What is Securities Fraud?*, *supra* note 97, at 540–41.

256. Fallone, *supra* note 146, at 98; *see also Musick*, 508 U.S. at 294.

in Section I.B, plaintiffs will be encouraged to avail themselves of those other sections precisely because of the increased difficulty of pleading scienter. From distinction comes refined definition.

Similarly, recognizing the moral dimension of fraud might offer a partial solution to the troubling trend of overcriminalization. In numerous areas of law, criminal sanctions are being used for behavior that, at first and even second blush, does not seem proportional.[257] If the moral dimension of securities fraud (and other civil laws) is recognized, it becomes a more attractive avenue for pursuing blameworthy behavior, and thus a better alternative than a continually expanding body of criminal law. In other words, the government can bring enforcement actions confident that success will bring with it similar benefits to those reaped from a criminal conviction. Criminal actions can then in turn be reserved for particularly egregious behavior, or other exceptional need.[258]

Recognizing the moral dimension of civil securities fraud may also serve as a first step toward addressing the unfortunate reality that criminal recklessness under the securities laws can be easier to prove than civil recklessness.[259] Case law in the civil securities context, particularly surrounding mental state requirements, is often used as precedent in criminal securities cases as well.[260] Yet courts sometimes implement a subjective recklessness inquiry in civil suits while implementing an objective one in criminal suits, taking guidance from the Model Penal Code's definition of recklessness as involving "a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation."[261] Recognizing the moral dimension of securities fraud emphasizes the closeness of the civil to the criminal and thus highlights this inconsistency. Bringing the cases closer together is a first step toward redrawing the boundary between them.

Finally, using the moral dimension of fraud to parse fraud sections from misrepresentation sections paves a path forward for more coherent and consistent congressional emendation. The moral dimension of civil securities fraud justifies affording the law more flexibility than what usually attaches to other sections. As discussed above,[262] "fraud is a legal concept designed to adapt alongside the evolving behaviors that it targets."[263] Recognizing that

257. *See, e.g.*, Coffee, *Unlawful*, *supra* note 30, at 195–96.

258. *Cf. id.* at 224–25.

259. *See* Olazábal & Abril, *Recklessness, supra* note 216, at 327–29; *supra* Section IV.C.1.b.

260. *See* Margaret V. Sachs, *Harmonizing Civil and Criminal Enforcement of Federal Regulatory Statutes: The Case of the Securities Exchange Act of 1934*, 2001 U. ILL. L. REV. 1025, 1041–42.

261. MODEL PENAL CODE § 2.02(2)(c) (AM. LAW INST., Proposed Official Draft 1985).

262. *See supra* notes 63–64, 97 and accompanying text.

263. Buell, *What is Securities Fraud?*, *supra* note 97, at 520 & n.22.

fraud has a moral dimension, and that notions of morality evolve—certain behaviors considered acceptable a century ago are horrifying to society today—leads to the conclusion that the law can and should be updated to reflect such changes. If securities fraud has become a method by which to target morally blameworthy behavior, lawmakers have a benchmark by which to amend the law to reflect changed understandings of what behavior is blameworthy. They can ensure that the law remains fresh and useful and that these amendments cohere with the laws' stated purposes.

E. A New Way to Consider Fraud Prevention

Finally, recognizing the moral dimension of civil securities fraud offers renewed reason to consider alternatives to litigation in addressing the prevention of corporate wrongdoing. Securities fraud litigation is morally charged because it targets behavior departing from established social norms, but it is not necessarily an effective means of defining or developing those norms.

It is hard to be optimistic when looking at the state of securities litigation today. We are facing a landscape where hundreds of fraud actions are brought each year, yet few make it to trial.[264] With little perceived connection between charging decisions and blameworthiness, those individuals (and businesses) that do end up being found liable appear to be victims of circumstance, or even scapegoats.[265] Familiarity has bred skepticism on the bench, particularly where securities class actions are concerned.[266] While this does not necessarily correlate to a disproportionate number of frivolous claims, it does suggest something is not working. And these developments are a sure way to erode public faith in the ability of the securities laws to police corporate conduct.

Even more dangerous is the effect of the current litigation landscape on corporate professionals. Securities class actions make up such a disproportionate number of class actions (a public company has approximately a two percent chance of having a securities class action brought against it in any given year)[267] that they are seen as an inevitable feature of doing business rather than as anything avoidable through proper behavior. Those found liable for

264. *See generally* Boettrich & Starykh, *supra* note 222, at 2–4, 41.

265. *Cf.* Larkin, *supra* note 19, at 14 (making the same point in the criminal context).

266. *See* Grundfest & Pritchard, *supra* note 181, at 635–36.

267. Thel, *Taking Section 10(b) Seriously, supra* note 15, at 32; *see also* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1539–40, 1548–49 (2006) [hereinafter Coffee, *Reforming Securities Class Action*] (pointing out that securities class actions comprised just under 50% of all class actions pending in federal courts and offering factors making such lawsuits likely).

securities fraud are considered unlucky rather than blameworthy.[268] Lack of peer censure makes for much less incentive to zealously work to avoid liability by obeying the law; the fact that individual defendants almost never contribute personally, relying instead on directors and officers liability insurance paid for by the company, doesn't hurt either.[269]

This Article devotes itself to outlining textual and interpretive shifts that will make for clearer, more principled, and—hopefully—more effective application of the securities fraud laws. And yet, when taking a step back, it can be hard to see how these, or indeed any, specific reforms can address the larger problem. Creating more rules to adhere to, and stricter penalties for violations, offers the comfort that we are doing *something* to address the issue, but brushes over the actual usefulness of such reforms.[270]

We need to understand what these laws can and cannot do. They can identify and police norms, but they are not a good tool for developing norms in the corporate community. The moral dimension of civil securities fraud highlights this shortcoming, and the need to look elsewhere for solutions. Ronald Colombo, for instance, persuasively argues in his review of *Moral Markets*, a collection of essays that examines the role of morality in the modern American economy, that the solution to corporate scandal is not stricter laws, but the earlier inculcation of virtue.[271] Other scholars have similarly chronicled the ways in which social norms, rather than legal rules, might be the best way to shape corporate behavior.[272]

Even the clearest and strictest of securities laws likely could not have prevented recent economic upheavals.[273] Instilling fear of legal censure, no

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268. *Cf.* Kahan, *Social Influence*, *supra* note 19, at 350 (pointing out that in communities where "crime is perceived to be rampant, individuals are less likely to form moral aversions to criminality").

269. *See* Coffee, *Reforming Securities Class Action*, *supra* note 267, at 1551.

270. *See* Thel, *Original Conception*, *supra* note 118, at 401 (offering a similar critique of historical public debates about financial reform).

271. Colombo*, supra* note 134, at 761–64.

272. *See, e.g.*, MACEY, *supra* note 1, at 253–73; John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2151 n.1 (2001) (collecting examples); Mark Klock, *Improving the Culture of Ethical Behavior in the Financial Sector: Time to Expressly Provide for Private Enforcement Against Aiders and Abettors of Securities Fraud*, 116 PENN ST. L. REV. 437, 488–93 (2011).

273. Traditional securities fraud—lying about the value of securities when offering them for sale—does not appear to be the main source of the 2008 financial collapse. The fault lies as much with purchasers and gatekeepers who failed to scrutinize the loans as they should as with any bad action by the loan originators. Coffee, for one, places the "direction of the causality" squarely from the investment banks purchasing securitized loans to the loan originators. *See* Coffee, *What Went Wrong?*, *supra* note 197, at 408; *see also* John C. Coffee, Jr., *Extraterritorial Financial Regulation: Why E.T.*

matter how severe, can only go so far as a deterrent. Rather, a corporate culture that emphasizes the commercial advantages of strict compliance in both letter and spirit is one to strive for. Dan Kahan has pointed out that people's moral convictions are shaped by their peers.[274] If that is true, then it is not in courtrooms and congressional committees that the most valuable work can be done, but in business school classrooms and Wall Street offices.

V. CONCLUSION

Dan Kahan has pointed out that law is so "suffused with morality" that it cannot "be identified or applied . . . without the making of moral judgments."[275] There will always be merit to examining what judgments are being made, particularly in a field as vast and complex as securities fraud. With any luck, the specificity of this Article's inquiry and its tangible conclusions offer some comfort to those who worry that we are arriving at a point where we recognize that the entire legal system stands on a moral foundation, leaving little reason to parse it in individual instances.[276] The multiplicity of such exercises does not lessen their individual merit. And when such assessments may shed light on new ways to maintain fair and efficient securities markets, the effort seems worthwhile.

Can't Come Home, 99 CORNELL L. REV. 1259, 1272–85 (2014) (offering a more detailed account of the financial collapse and regulatory response).

274. *See* Kahan, *Social Influence*, *supra* note 19, at 358–59.

275. Kahan, *Ignorance of Law*, *supra* note 7, at 128.

276. *See* RONALD DWORKIN, LAW'S EMPIRE 1 (1986). Dworkin states that "[t]here is inevitably a moral dimension to an[y] action at law," and it is the judge's task to "decide not just who shall have what, but who has behaved well, [and] who has met the responsibilities of citizenship." *Id.*